STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

WISCONSIN ENERGY CORPORATION, INTEGRYS ENERGY GROUP, INC., PEOPLES ENERGY, LLC, THE PEOPLES GAS LIGHT AND COKE COMPANY, NORTH SHORE GAS COMPANY, ATC MANAGEMENT INC., and AMERICAN TRANSMISSION COMPANY LLC	)	
Application pursuant to Section 7-204 of the Public Utilities Act for authority to engage in a Reorganization, to enter into agreements with affiliated interests pursuant to Section 7-101, and for such other approvals as may be required under the Public Utilities Act to effectuate the Reorganization.	)	**DOCKET No. 14-0496**

INITIAL BRIEF
OF
THE CITY OF CHICAGO AND THE CITIZENS UTILITY BOARD

PUBLIC

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The City of Chicago ("City") and the Citizens Utility Board ("CUB") (together "City/CUB"), pursuant to Section 200.800 of the Rules of Practice of the Illinois Commerce Commission ("ICC" or "Commission"), 82 Ill. Adm. Code 200.800, and the briefing schedule established by the Administrative Law Judge ("ALJ") in this case, file their Initial Brief in this proceeding.

I. INTRODUCTION

In this proceeding, the Commission must assess a reorganization proposal that does not meet the statutory criteria for approval of a reorganization and is purposefully minimalist in its presentation of information regarding post-reorganization plans, impacts, and operational detail. The Commission is asked to adopt the Joint Applicants' unlawfully narrow view of the PUA requirements for approval and to accept a proposal tailored to arguments that put the maximum amount of information outside Commission inquiry.

For instance, the Joint Applicants assert that, though savings are expected, this proposed reorganization is not based on anticipated savings. Application at 23; JA Ex. 3.0 (Reed) at 32:670. While the delay in quantifying "10s of millions" (Tr. 369 (Reed)) in integration costs for the reorganized companies means those costs cannot be considered in assessing reorganization impacts in this case, the Joint Applicants propose that those costs would be considered for rate recovery in post-freeze rate cases. JA Ex. 15.1 Rev., Commitments 1 and 21. The success of this strategy requires that the Commission accept -- as credible and prudent -- a multi-billion dollar transaction that does not have a plan for transitioning to an integrated organization, an

estimate of the costs and savings of post-transaction restructuring, or an assessment of whether those costs will negate expected holding company financial benefits.

The success of the Joint Applicants' strategy depends as much -- if not more -- on the Commission's adoption of the Joint Applicants' "no net harm"[1] standard for regulatory approval. JA Ex. 8.0 (Reed) at 3:63. Under the Joint Applicants' legal theory, the Commission cannot require any improvement as a condition of approval -- "whether a reorganization will improve or enhance a utility's ongoing operations or service quality is immaterial to the Commission's consideration of whether or not to approve a reorganization."[2] In particular, the Joint Applicants contend the Commission cannot order the correction of declining utility performance in PGL's Accelerated Main Replacement Project ("AMRP"), and the Commission cannot act proactively in other areas to avoid foreseeable adverse impacts. JA Ex. 3.0 (Reed) at 41:824. According to the Joint Applicants, as long as things are not immediately worse, approval must be granted.

For instance, on that basis, the Joint Applicants provided no information on post-reorganization plans for continued remediation of PGL's dysfunctional implementation of its AMRP. However, even under their flawed statutory interpretation, where (as here) the evidence shows that improvement is necessary for the utility to perform its statutory duties, to meet other threshold criteria, or to protect customers' interests, the minimum requirements of 7-204(b) do not control. In particular, merely maintaining deficient (and arguably declining) AMRP performance would "adversely affect the utility's ability to perform its duties under [the PUA],"

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[1] The Commission has considered and rejected utility-wide determinations of net reorganization impacts. Re *Nicor Merger* at 30. Specific statutory requirements preclude offsetting impermissible deficiencies (in one or more areas) with putative gains in another.

[2] Joint Applicants' Response in Opposition to GCI's Requests For Subpoenas on Liberty Consulting Group Auditors at 3; *see also* Joint Applicants' Response to the Petition of GCI for Interlocutory Review of the ALJ's Decision Limiting Use of the Liberty Interim Report at 4-5.

and it would not "protect the interests of the public utility and its customers." 220 ILCS 5/7-204(b)(1) and 7-204(f)).[3] In such circumstances, the Commission is authorized and required to impose additional requirements as conditions of reorganization approval. *Id.*

A related Joint Applicants tactic paints the proposed reorganization as a simple stock transaction that does not require any examination of their post-reorganization implementation plans regarding problematic utility programs and policies. JA Ex. 6.0 (Leverett) at 13:356, 18:503. The Joint Applicants argue that their plans (or lack of plans) to address such situations post-reorganization are irrelevant to a decision on a simple sale of stock, and that no operational examinations are necessary to satisfy PUA requirements, because a sale will not make current circumstances any worse. This obvious slight-of-hand should not turn the Commission's attention from dangerous utility plant, problematic construction management, or troubling audit reports -- all legitimate concerns in the proposed transaction.

To decide this case correctly, the Commission must confirm its proper regulatory role under PUA Section 7-204. The Commission is not, as the Joint Applicants argue, a rubber stamp for proposals that only just meet threshold requirements of Subsection 7-204(b). The Commission is required to make additional substantive factual and policy determinations, like those specified in subsections 7-204(c) and (f), *inter alia*. The Joint Applicants interpret the PUA to give free rein to holding company level transactions, and to require only assertions of "no harm" for approval of such reorganization proposals. The Illinois General Assembly's response to an earlier holding company evasion of regulatory oversight strongly suggests a different intent. The legislature prioritized protection of the current and future interests of

[3] Because 220 ILCS 5/7-204 governs this proceeding and is mentioned repeatedly in this Initial Brief, for ease of reference "Section 7-204" (sometimes with subsections) is used.

ratepayers and utility service providers above utilities' leeway to reshape themselves without meaningful Commission oversight and promptly passed legislation to assure comprehensive Commission oversight and regulation, including protection of public interests.

II. THE APPLICABLE LEGAL STANDARDS

The starting point for the Commission's consideration of any request for approval of a proposed reorganization is the threshold test of Section 7-204(b): "The Commission shall not approve . . . if the Commission finds . . . that the reorganization will adversely affect the utility's ability to perform its duties under [the PUA]." *See* Section 7-204(b). The same subsection lists seven specific evidentiary findings that are preconditions to Commission approval. The language of Section 7-204 also is clear that merely ticking off the statutory "no harm" checklist does not entitle an applicant to Commission approval of a proposed reorganization. The PUA requires further specific Commission determinations -- in addition to those listed in Section 7-204(b) -- that are consequential to Illinois utilities and ratepayers, broader and more demanding than the mere absence of affirmative harm, and necessary to effect relevant legislative and Commission policies.

The Commission has clear authority and broad discretion to "impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers," in approving any proposed reorganization. Section 7-204(f). These responsibilities require examinations sufficient in scope and detail to ascertain (a) whether conditions are necessary to protect the interests of ratepayers and (b) what protective terms or conditions are required by the circumstances of the proposed reorganization. Despite this statutory provision, the Joint Applicants argue that if their proposed reorganization causes no harm, the Commission must approve the proposed reorganization. *See* JA Ex. 3.0 (Reed) at

41:824; n. 1, *supra*.

The relevant statutory provisions, which the Commission will be called upon to apply, do not support the Joint Applicants' minimally demanding standard. The Commission must verify compliance with Section 7-204's threshold requirements, make additional determinations required by the statute, and assess the immediate and future impacts of the proposed reorganization. These steps are necessary precursors to a Commission decision on whether to approve a reorganization proposal and (if it is approved) to Commission determinations that define and impose needed protections for the interests of Illinois utilities and ratepayers.

As City/CUB show in this brief, the Joint Applicants' interpretation of the applicable statute is not consistent with governing law, and their proposal fails to satisfy important elements of the full slate of substantive Section 7-204 requirements. The only legally sustainable interpretation of the statute gives effect to all applicable statutory provisions and to the legislative policy that the interests of Illinois utilities and ratepayers should be protected, no matter the form or details of a proposed reorganization.

A. The Applicable Statutory Requirements

The PUA provisions most pertinent to this proceeding are Sections 7-204, and 7-204A of the Act, which address reorganization approval comprehensively. While Section 7-102 remains in effect, it has been narrowly interpreted, and arguably does not apply to those aspects of the Joint Applicants' proposal addressed in this brief. Where these complementary provisions overlap (e.g., affiliate agreements), the Commission has declined to rule on whether Section 7-102 applies in addition to Section 7-204, holding that findings under Section 7-204 are an adequate basis for approval under Section 7-102. *Re WPS Resources*, ICC Dkt. 06-0540, Final Order of February 7, 2007 at 63. In other words, "both essentially apply a public interest test,

and both authorize Commission discretion to impose conditions." *AGL Resources Inc., Nicor Inc. and Northern Illinois Gas Company d/b/a Nicor Gas Company, Application for Approval of a Reorganization Pursuant to Section 7-204 of the Illinois Public Utilities Act*, ICC Docket No. 11-0046, Final Order of December 7, 2011 at 38 ("*Nicor Merger*"). Accordingly, City/CUB will address Section 7-102 further only if related issues are raised.

Section 7-204 is the provision expressly relied upon by the Joint Applicants in their application, and its applicability is not questioned. Application at 1. As shown below, Section 7-204 provides the Commission with more expansive jurisdiction than Section 7-102, the PUA's earlier reorganization provision. Section 7-204 also lists specific threshold requirements as pre-conditions to any exercise of Commission approval authority. The Commission must make each of the factual findings, based on the record evidence, before it can exercise its authority to approve a reorganization. 220 ILCS 5/7-204(b); 5/10-103. Section 7-204(b) provides:

> (b**) No reorganization shall take place without prior Commission approval. The Commission shall not approve any proposed reorganization if the Commission finds, after notice and hearing, that the reorganization** will adversely affect the utility's ability to perform its duties under this Act. In reviewing any proposed reorganization**, the Commission must find that:**
>
> (1) **the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service**;
>
> (2) the proposed reorganization **will not result in the unjustified subsidization of non-utility activities** by the utility or its customers;
>
> (3) **costs** and facilities **are fairly and reasonably allocated between utility and non-utility activities** in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes;
>
> **(4) the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;**

> (5) **the utility will remain subject to** all applicable laws, regulations, rules, decisions and **policies governing the regulation of Illinois public utilities;**
> (6) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;
> **(7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.**

220 ILCS 5/7-204(b) (emphasis added to reflect focal areas of City/CUB's brief).

Additional substantive determinations respecting the allocation of reorganization savings, the need to impose protective conditions, and the substance of such conditions are required by sub-Sections 7-204(c) and (f).

> (c) The Commission shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.
>
> (f) In approving any proposed reorganization pursuant to this Section **the Commission may impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers.**

220 ILCS 5/7-204(c) and (f) (emphasis added to reflect focal areas of City/CUB's brief).

B. The History of Section 7-204

The history of the PUA's merger/reorganization provisions is instructive. In 1981, the Commission entered a citation order requiring Peoples Energy (PGL's parent at that time), PGL, North Shore Gas Company, and other holding company/non-utility parties in a proposed reorganization to show cause why the proposed reorganization was not subject to Commission jurisdiction, and (if it was) why the reorganization would be in the public interest. The courts rejected the Commission's jurisdictional claims respecting the reorganization, which -- like the

proposal here -- directly involved only a transaction between holding companies (not public utilities). *See generally Peoples Energy Corp. v. Ill. Commerce Comm'n*, 142 Ill. App. 3d 917 (1986 1st Dist.).

The PUA provisions pertinent in this case were enacted in direct response to the successful efforts of PGL's former parent firm to avoid Commission review of a holding company level reorganization. Section 7-204(a) redefined covered reorganizations to assure Commission jurisdiction, authority, and discretion in its oversight, investigation, and conditional approval of proposed reorganizations in any form. *See, e.g.*, 220 ILCS 5/7-204(a) (defining "reorganization" for purposes of Commission jurisdiction); *also* 84th Ill. Gen. Assemb., House Debate transcr., 61st Day at 236; 84th Ill. Gen. Assemb., Senate Debate transcr., May 21, 1965 at 86. In addition to Section 7-204(b)'s threshold list of required "no harm" findings, other subsections provide clear statutory authority for the Commission to examine other circumstances, as necessary, to determine the need for and the form of circumstance-based approval conditions to protect Illinois utilities and customers. Section 7-204(f) provides explicit authority for the Commission to assess how the proposed reorganization would affect the public interest, and to impose curative terms or conditions as required.

The mandated comprehensive examination of reorganization proposals and imposition of conditions to protect the public interest furthers the legislative policies of effective and comprehensive utility regulation and equitable treatment of utilities and consumers. 220 ILCS 5/1-102; 102(d); 102(d)(iii). As a matter of law and policy, the Commission's evidentiary inquiry must examine numerous areas of an affected utility's operations -- from the perspectives of the public interest, the regulated utilities, ratepayers, and effective regulation. The importance of comprehensive regulatory oversight and customer protection was emphasized by the

legislature's speedy reaction to the decisions culminating in *Peoples Energy Corp.* 220 ILCS 5/7-204. Asking only whether a proposed reorganization meets the minimum statutory thresholds does not satisfy the statute or the broader policies underlying Section 7-204's grants of authority and discretion to the Commission.

Each provision of Section 7-204 must be given substantive effect. "A statute should be construed so that no word or phrase is rendered superfluous or meaningless." *Kraft, Inc. v. Edgar*, 138 Ill 2d 178, 189 (1990). Focusing exclusively on the threshold findings of Section 7-204(b) unlawfully excises all other provisions of the statute. "[I]n ascertaining the meaning of a statute, the statute should be read as a whole with all relevant parts considered." *Id.*

C. The Burden of Proof

The Commission has held that in Section 7-204 proceedings, the statutory language effectively places the burden of proof with the applicant seeking reorganization approval.

> Moreover, the structure of subsection 7-204(b) puts the burden of satisfying its sub-parts on the reorganization petitioner. That is, the text of that section precludes merger approval *unless* the specified findings can be made. Thus, the adverse consequence of presenting insufficient evidence for the Commission to make the requisite findings fall upon the JA here.

Nicor Merger at 45 (emphasis in original). Accordingly, any gaps or deficiencies in the record evidence -- resulting from, for example, the Joint Applicants' tactical decisions regarding their selection of witnesses and the scope of their testimony -- must weigh against the Joint Applicants. *See* Tr. 127 (inquiry into utility impacts and interests blocked by Joint Applicants' tactical decision not to present utility witnesses: "The witnesses Joint Applicants chose to present cover the subject matter they chose to cover."). Similarly, deliberately narrow testimony that

precludes development of a record that shows that public interest considerations are adequately addressed also must weigh against the Joint Applicants.

Consequently, restrictions on the use of certain evidence in this case, the Liberty Interim Report and on related testimony in particular, may have the unintended effect of weakening the Joint Applicants' case for approval. For example, in the *Nicor Merger*, the Commission found evidence "that the JA are conducting this process [of cooperative, multi-company, pre-transaction integration planning] with a significant commitment of personnel is itself evidence that service quality will be maintained after reorganization." *Nicor Merger* at 45. In this case, inquiries through discovery and examination of testimony regarding such activities were limited by the Joint Applicants' claims that such activity is not relevant or occurring, and by related ALJ evidentiary rulings. At the same time, testimony showing a lack of such preparation is itself probative, as to the likelihood of a seamless AMRP transition and certain other post-reorganization impacts.

D. The Joint Applicants' Arguments

First, the Joint Applicants contend that the Commission is <u>required</u> to approve the proposed reorganization if the record supports the required findings of Section 7-204(b). JA Ex. 3.0 (Reed) at 41:824 ("[T]he Commission shall approve a reorganization if it finds that the reorganization will not adversely affect the utility's ability to perform its duties under the Public Utilities Act."). Mr. Reed's lay opinion was confirmed as the Joint Applicants' legal position in later pleadings. Joint Applicants' Response in Opposition to GCI's Requests For Subpoenas on Liberty Consulting Group Auditors at 3; *see also* Joint Applicants' Response to the Petition of GCI for Interlocutory Review of the ALJ's Decision Limiting Use of the Liberty Interim Report at 4. However, Subsection 7-204(b) contains only a prohibition ("Commission shall not approve

any proposed reorganization if . . . .") -- not a directive. The provision does not mandate approval if the threshold findings are made, only that the Commission must make those findings before it can exercise the authority and discretion granted in other subsections of Section 2-704.

The Joint Applicants' parallel argument is that the Section 7-204(b) findings are equivalent to or subsume the utility and customer interests identified in Section 7-204(f). As explained earlier, the public interest provisions of the governing statute must be given substantive meaning. They cannot be ignored by assuming that they are nothing more than the threshold requirements of section 2-704(b).

The Joint Applicants rely on a dated Commission decision to support their argument that Section 7-204(f) has no independent significance. "[T]the seven findings the Commission is required to make under Section 7-204(b) have "the very effect of . . . protect[ing] the interests of the utility and its customers." Joint Applicants' Response to Petition for Interlocutory Appeal at 4 (*citing In re SBC Communications, Inc., et al.*, ICC Dkt. No. 98-0555, 1999 Ill. PUC LEXIS 738 (Sept. 23, 1999)). That statutory interpretation would completely nullify the legislature's explicit grant of authority to impose conditions necessary to protect the interests of Illinois utilities and ratepayers in Sections 7-204(c) and 7-204(f).

The described nullification effect makes the Joint Applicants' interpretation unlawful, as it conflicts with binding Illinois Supreme Court precedent. Under long-standing and determinative case law, every provision of Section 7-204 must be given substantive meaning. *Kraft, Inc. v. Edgar*, 138 Ill 2d 178 (1990) at 189 ("A statute should be construed so that no word or phrase is rendered superfluous or meaningless."). Similarly, the statutory provisions requiring Commission determinations of whether a proposed reorganization is in the public interest (Section 7-102) or adequately protects the interests of Illinois utilities and ratepayers (Section 7-

204(f)) cannot be ignored or given no weight. *Id.* ("in ascertaining the meaning of a statute, the statute should be read as a whole with all relevant parts considered"); 220 ILCS 5/7-102, 5/7-204(f).

Even if, at one time, the Commission accepted the Joint Applicants' position, the Commission has since recognized its error and abandoned that Applicants' interpretation. In the more recent *Nicor Merger* proceeding, the Commission examined the statute's application more thoroughly. In its decision in the *Nicor Merger*, the Commission interpreted and applied Section 7-204 in a manner fully consistent with the Illinois Supreme Court's guidance on statutory construction. The Commission found that the public interest provisions of Section 7-102 and Section 7-204 provide independent authority that does not depend on, and is not subsumed by, Section 7-204(b)'s list of threshold criteria. *Nicor Merger* at 43-45, 56. The Commission further emphasized that distinct authority by holding that "Subsection 7-204(f) does not exempt any component of utility operations from its purview," and by using that expansive, independent authority in its determinations. The Commission ordered corrective conditions in areas where the threshold approval requirements of 204(b) would otherwise have not been satisfied (*id.* at 72, 81) and where public interest considerations required conditions on the Commission's approval (*id.* at 66, 77, 81).[4]

The burden of proof in this proceeding means City/CUB and other parties are not required to show that the harms described in Section 7-204(b)'s threshold criteria will result from the proposed reorganization. The Joint Applicants' evidence must support Section 7-204(b)'s

[4] City-CUB notes that if Section 7-204(f) has no independent significance, the Commission would have no authority or discretion to impose corrective conditions that would allow reorganization approval. The Commission would be compelled to vote "up or down" on reorganization proposals precisely as proposed, and would lack authority or discretion to "fix" an inadequate proposal.

threshold findings, at the statutory level of certainty To gain Commission approval, the Joint Applicants also must provide record evidence that allows the Commission to define curative conditions to protect the public interest, if needed. The Joint Applicants have not met those burdens.

In fact, the Joint Applicants' proposal and evidence fail to meet the requirements of even their own unlawfully narrow statutory interpretation. The Joint Applicants have strategically declared that no post-transaction planning has begun, no decisions for post-transaction staffing and operations have been made, and that no post-transaction costs or savings have been estimated. The resulting record is so lacking in meaningful information about the impacts of the proposed reorganization that it is impossible for the Commission to conclude that the reorganization will not have prohibited impacts that preclude Commission approval.

E. The Effect of the Joint Applicants' Commitments

Commitments made or terms and conditions imposed to help meet statutory pre-conditions to reorganization approval should: assure that the pertinent requirement is, in fact, met; permit effective Commission oversight and compliance enforcement; and define consequences that effectively deter non-compliance. *See* City/CUB Ex. 4.0 at 23:555. Since the required Commission findings must be made in this proceeding -- not at some later date -- the commitment or conditions must be (a) defined and in-place, (b) effective in preventing adverse impacts, and (c) immediately operative. If the Commission cannot make the required findings now, the mandated level of protection for Illinois utility and customer interests is not achieved.

Supplemental elements that help a proposal satisfy statutory requirements also must include well-defined metrics or qualitative bright lines, to enable effective oversight of compliance, consistent with legislative and regulatory policy. Since after-the-fact punishment or

remediation is unlikely to be timely, certain, and capable of reversing prohibited impacts, clear non-compliance deterrents are essential. If commitments or other supplements to the Joint Applicants' basic proposal do not provide the level of certainty necessary to meet pertinent statutory requirements, the required pre-approval evidentiary findings cannot be made.

F. Conclusion

The threshold findings of Section 7-204(b) permit -- but do not require -- the exercise of the Commission's reorganization approval authority. The Joint Applicants' evidence does not support the required Commission findings.

As this brief demonstrates, several of the threshold findings of Section 7-204(b) have not been met. In addition, the Joint Applicants do not even address the public interest assessments required under Sections 7-102 and 7-204, which remain fully effective and independent of the threshold findings. The Joint Applicants' proposed commitments (in addition to being inadequate as explained below) must prevent the statutory adverse impacts they are designed to address, otherwise the Commission cannot approve the reorganization. The evidentiary restrictions on an on-the-record examination of PGL's multi-billion dollar infrastructure modernization program have severely curtailed the record in this case and made fully informed assessments of several statutory issues impossible.

The record in this case does not contain the necessary evidentiary showings, at the statutory level of certainty, for several provisions that protect the interests of Illinois utilities and customers. Those failures of proof preclude Commission approval of the proposed reorganization.

III. THE EVIDENCE DOES NOT SUPPORT A CONCLUSION THAT THE STATUTORY RATEPAYER PROTECTION THRESHOLDS FOR REORGANIZATION APPROVAL HAVE BEEN MET

A. Section 7-204(b)(1) -- ability to meet PUA service obligations not diminished

The PUA allows the Commission to impose conditions necessary to protect the interests of PGL's ratepayers. 220 ILCS 5/7-204(f). The PUA *requires* the Commission to (1) protect PGL and NS ratepayers from adverse rate impacts and (2) find that the proposed reorganization will not "diminish [PGL's] ability to provide adequate, reliable, efficient, safe and least-cost public utility service." 220 ILCS 5/7-204(b). The PUA *does not require* the Commission to approve any proposed reorganization, regardless of its findings.

The AMRP is an acceleration of a pre-existing main replacement program that contemplates completion over the next 20 years, during which time PGL plans to: (1) replace all of its cast-iron and ductile-iron gas mains and service pipes; (2) upgrade its distribution system from low to medium pressure; and (3) relocate gas meters from inside to outside customer facilities. JA Ex. 1.0 at 18:397-400. The project is critical to the safety and adequacy of gas delivery utility service in Chicago. City/CUB Ex. 3.0 at 82-83. The Joint Applicants commit to continue AMRP if the proposed reorganization is approved, but only if the Commission accepts their proposed conditions that: (1) Rider Qualifying Infrastructure Plant ("QIP") remains in effect and (2) PGL will be able to change its base rates to reset the Rider QIP cap, among other conditions. JA Ex. 1.0 at 19:403-410. In 2014 and 2015 alone, PGL expects to spend $536 million in capital expenditures related to AMRP, representing approximately two-thirds of its capital expenditures during that period. City/CUB Ex. 3.1 (JA DRR to Staff ENG 1.02).

The Commission should reject the Joint Applicants' proposed reorganization. If the Commission instead approves, PGL's AMRP must not be managed and operated as a consequence-free funding stream. The ICC should not allow an out-of-state parent corporation to guarantee shareholder dividends with revenue from Chicago ratepayers, intended solely for this massive infrastructure project of critical importance to the safety and reliability of the system providing utility services.

Before applying relevant provisions of the PUA, a discussion of the appropriateness of AMRP-related conditions on any reorganization approval is instructive.

1. Commission-Imposed Conditions on AMRP are Appropriate for This Proceeding

As noted throughout this Brief, the PUA's reorganization provisions expressly grant the Commission clear authority and broad discretion to "impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers," in approving any proposed reorganization. 220 ILCS 5/7-204(f). In addition, the PUA prohibits the Commission from approving any reorganization that if finds "will adversely affect the utility's ability to perform its duties under this Act." 220 ILCS 5/7-204(b). The Commission is also prohibited from approving a reorganization unless it finds that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service." *Id.* The PUA further prohibits approval of a reorganization unless the Commission finds that "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers." *Id.*

This proceeding is not the first time the Commission has considered PGL's pipe replacement program as part of a Section 7-204 reorganization. As a condition to the previous

reorganization that created Integrys Energy Group, Inc., the Commission required PGL to pay for studies of PGL's "main replacement program," including requirements for specific operational and management changes to the program and future reports of "the status of Peoples Gas' cast and ductile iron main replacement program." *WPS Resources Corp., Peoples Energy Corp., The Peoples Gas Light and Coke Co., and North Shore Gas Co.*, ICC Docket No. 06-0540, Final Order of February 7, 2007 at 12 ("*Peoples Gas"*). In other reorganization proceedings under Section 7-2024, the Commission has also required that, as a condition of approval, subject utilities be prohibited from engaging in certain transactions, agree to cost allocations , agree to audits of certain service providers, and agree to cost of service studies and billing reports. *See, e.g., Atmos Energy Corp. and Liberty Energy (Midstates) Corp.*, ICC. Docket No. 11-0559, Final Order of June 27, 2012 at 56-61.

In this case, use of certain evidence regarding AMRP has been limited by ALJ ruling. A report of AMRP audit findings could only be used to address whether the Joint Applicants are ready, willing, and able to take on the program. But even under the ruling's restrictions, Commission imposition of conditions regarding AMRP is appropriate. In other cases, when required to assess whether an entity was "interested, willing and able" to provide utility service in a reorganization proceeding, the Commission has considered what concrete steps were taken and the specific plans that were formulated. *Aqua Ill., Inc.*, ICC Docket. No. 09-0369, Final Order of May 5, 2010 at 12 (rejecting assertion that entity had taken steps of formulate plans to "improve and expand" system). In finding that an entity was not "ready, willing or able" to serve a particular area of customers, a reviewing court has relied on evidence -- or lack thereof -- regarding the assets of the subject entity and the "conclusory" nature of witnesses' statements.

Northern Moraine Wastewater Reclamation Dist. v. Ill. Commerce Comm'n, 392 Ill. App. 3d 542, 567 (2nd Dist. 2009).

The ALJ's ruling focuses the Commission's inquiry into satisfaction of the statutory requirements noted above on WEC's readiness, willingness, and ability to implement changes to AMRP. The Joint Applicants concede that the ability of the new owner to manage AMRP properly is relevant to this proceeding, and that, if left uncorrected; the acknowledged AMRP mismanagement can worsen performance (an expectation that does not satisfy the threshold statutory requirements for approval). Tr. 328:10-14, 329 (Hesselbach). City/CUB's testimony presented by Mr. William Cheaks Junior illustrated the negative public safety, reliability, quality-of-life, and infrastructure coordination impacts that a poorly managed AMRP can impose on Chicago's ratepayers. Mr. Cheaks, Deputy Director of CDOT's Division of Infrastructure Management, has over 34 years of experience in the construction industry. In those 34 years, he has served in many capacities and levels of construction operations and management. City/CUB Ex. 3.0 at 7-20. At CDOT, Mr. Cheaks' responsibilities include overseeing 100+ employees in the Office of Underground Coordination ("OUC"), the Citizens Utility Alert Network ("DIGGER"), the Public Way Permit Office, the Project Coordination Office ("PCO") and Public Right-of-Way Enforcement. Mr. Cheaks established the PCO from concept to implementation in mid- 2011 in an effort to save all stakeholders money, time, and hassle. City/CUB Ex. 3.0 at 22-26.

This proceeding is an appropriate, and in fact the <u>only</u>, proceeding in which the Commission can impose conditions on the continued operation of AMRP in the context of the proposed reorganization, to protect the interests of PGL's ratepayers. Any other proceedings

(such as future Rider QIP reconciliation proceedings or future rate cases) will only occur after the reorganization is approved or denied by the Commission.

Referring to the proposed Wisconsin Energy purchase of the common stock of Integrys Energy Group, the Joint Applicants assert that "[o]ther than this change in corporate ownership, the proposed Reorganization will leave [PGL and NS] essentially unchanged." JA Ex. 6.0 at 8:256-259, 9:261-265. Contrary to the Joint Applicants' assertion, it is indisputable from the record evidence that the proposed reorganization will change the management and operation of AMRP. Tr. 137 (Schott, re budgets and funding); *also* Tr. At 151-152, 20-22 (Leverett, significant decisions would receive input from the holding company). The Joint Applicants concede this point as to construction management in touting their own purported expertise in managing large infrastructure projects in public ways as a plus. In fact, the Joint Applicants have stated their intention to change (1) the management responsible for AMRP at PGL itself, and (2) the parent company's management responsible for AMRP. JA March 18, 2015 Response to Commissioners' Data Request at 3.

Mr. Cheaks' testimony confirms the myriad ways in which the proposed reorganization will change the management and operation of AMRP – from a change in lobbyists who influence legislation affecting AMRP, to a change in design and engineering personnel who work directly on AMRP, to a change in who decides the budgetary and financial aspects of AMRP, and to new policies and procedures applicable to AMRP construction activities. As Mr. Cheaks testified, "[c]ritical decisions like funding, pace of construction, and coordination with the City for work in Public Ways (in the event of reorganization approval) will ultimately no longer be made by management personnel sitting atop the aged infrastructure now being replaced." City/CUB Ex. 3.0 at 112-115. In the past, the Chicago Department of Transportation ("CDOT") has had to

contact Mr. William Evans, President of PGL at the time, to obtain timely and accurate information on a construction project in the City. If the President of PGL is corresponding with CDOT on day-to-day operational questions, it is reasonable to assume that significant decisions regarding AMRP are made at least one level in the corporate hierarchy above PGL's President. City/CUB Ex. 7.0 at 49-58. Even in this proceeding itself, the Joint Applicants submitted testimony regarding AMRP from an employee of PGL's holding company affiliate, not a representative of PGL management. City/CUB Ex. 7.0 at 49-58. Absent concrete commitments from the Joint Applicants, knowledgeable employees who work on AMRP now may not be the same employees who work on AMRP in the future. Although the Joint Applicants describe the proposed reorganization as just a "stock transaction", this proposed transaction would have a very real effect on the personnel, decisions, and policies affecting implementation of AMRP.

Further confirmation of the effect the proposed reorganization would have on PGL's AMRP came from the Liberty Consulting Group's Interim Audit Report, which also examined the impact of changing management on implementation of AMRP. Staff's proposed AMRP conditions also support the conclusion that the proposed reorganization will have a material effect on AMRP.

In its testimony, City/CUB provided the table below detailing the proposed reorganization's anticipated effects and the evidence relied upon for those effects:

Proposed Reorganization's Effects	**Evidence**
Change in Distribution Design personnel and management who are	All capital design gas main projects are submitted to OUC by IBS Gas Engineering, IBS Gas Engineering personnel attend monthly DWM

currently employed by business services affiliate	Construction Utility Coordination meeting; IBS Gas Engineering send conflicts with existing gas main to OUC; IBS Gas Engineering provide 5 year Capital Improvement Project lists to CDOT PCO; IBS Gas Engineering reviews third party OUC submittals for conflicts with existing gas mains (City/CUB Ex. 3.1 (JA DRR to City 3.05))
Change in board and shareholder compositions on scheduling and budgeting decisions (removal from Illinois)	The parent company's Board of Directors' role in approving or disapproving large capital investments programs.
Change in parent company on operational decisions (removal from Illinois)	Affiliate project cost reporting systems (JA DRR to Staff ENG 3.05 Attach 01, Issue IDs 226, 227, 228, 235, 240); Parent company practice on Issues Management Process, including responses to audit findings (JA DRR to Staff ENG 3.05 Attach 01, Issue IDs 259, 260); Parent company document management tools (JA DRR to Staff ENG 3.05 Attach 01, Issue ID 260); Parent company Process Guidelines for Risk Management (JA DRR to Staff ENG 3.05 Attach 01, Issue ID 262); Affiliate engineering review of Schedule of Values (JA DRR to Staff ENG Attach 01, Issue ID 281);
Change in holding company's relationships with interested stakeholders, including local and state lawmakers, whose decisions affect legislation regarding AMRP	Public Act 98-0057, http://www.ilsos.gov/ lobbyistsearch/lobbyistsearch (Integrys), Chicago City Council Resolutions (e.g. R2014-282), Chicago City Council Grants of Privilege (e.g. O2014-683, 2013-1125), and Chicago City Council Ordinances, https://data.cityof chicago.org/Ethics/Lobbyist-Data-Lobbyist-Registry-2012-to-present/ypez-j3yg? (Integrys as Employer or Client)
Loss of local decision maker presence	Decision makers who see local problems daily or share the same utility service experience as Chicago customers are more likely to appreciate and respond to local problems.

Finally, the unavoidable need for the Commission to address the future of PGL's AMRP in this proceeding is shown by a litany of Joint Applicant concessions that demonstrate the pervasive involvement of PGL's parent and affiliate companies (which reorganization would change) in the management and operation of AMRP.

- "The Joint Applicants concede that the holding company Board of Directors "makes decisions regarding the overall resources for AMRP." City/CUB Ex. 7.1 (JA City 10.37).

- The Joint Applicants believe that Wisconsin Energy's experience overseeing infrastructure investment programs is "highly relevant" to PGL's AMRP because it demonstrates that "senior management of the new holding company for Peoples Gas is knowledgeable and experienced in the management and oversight of large capital projects like Peoples Gas' AMRP." City/CUB Ex. 7.1 (JA City 10.39).

- The holding company Board of Directors must approve any transaction of $15 million or above (which certainly affects AMRP. City/CUB Ex. 7.1 (JA City 8.02, Attach 01).

- PGL uses its holding company's software systems for cost data. City/CUB Ex. 7.1 (JA City 8.03). The Joint Applicants have not indicated whether the current system will be replaced by another system more compatible with the IT environment of the new parent company.

Regarding Wisconsin Energy's experience as a replacement for Integrys', Mr. Cheaks testified that it does not "give [him] confidence that PGL's AMRP will be managed any better than it already is." City/CUB Ex. 3.0 at 914-915. WEC was unable to provide its costs for compliance with Milwaukee's Public Way repair regulations, and it does not track costs for noncompliance with those regulations, a lack of performance tracking CDOT found disconcerting. CUB Ex. 3.1 (JA-City 4.04). In addition, neither WEC nor any other Joint Applicant requested PGL to provide a detailed work plan of the AMRP as part of its due diligence review. CUB Ex. 3.1 (JA-AG 4.01). The Joint Applicants' Agreement and Plan of

Merger does not even address AMRP, a multi-billion dollar program and the largest ever undertaken by the utility. JA Ex. 1.1. WEC also has no transition plan for AMRP. Moreover, WEC has "no specific plans at the present time with respect to the use of WEC Energy Group's cash flows for the funding of Peoples Gas' AMRP." CUB Ex. 3.1 (JA-City 2.22). Relying on long-distance management that takes such a casual approach to PGL's most important infrastructure program does not support a conclusion that the proposed reorganization will not diminish PGL's provision of safe and adequate service. City/CUB Ex. 3.0 at 895-908. Only pure speculation (or blind hope) could lead the Commission to make a determination that service will not be adversely affected.

The Joint Applicants ask the Commission to ignore the trend line of PGL's AMRP implementation and focus on their claim that "protection of the interests" of utilities and their customers means only preventing affirmative harm, immediate diminishment of ability to serve, or other adverse effects -- not requiring that the interests of those parties or utility performance be improved. AG Ex. 5.1. They argue that "improvement of deficiencies" in operations like AMRP is above and beyond what is required for the protection of interests. The point the Joint Applicants miss is that the Commission is not required to approve *any* reorganization. If the record indicates, as it does here, that already dysfunctional implementation of the largest capital program in PGL's history might get worse if decline continues under new ownership or if unacceptable service will not improve, then the Commission need not approve the proposed reorganization, regardless of the findings made.

As Mr. Cheaks noted, "[u]nsafe or inefficient implementation could actually harm Illinois ratepayers' interests, if the Commission does not act to compel correction of AMRP deficiencies and to disallow imprudent expenditures." City/CUB Ex. 7.0 at 193-195. As independent

corroboration for the proposition that changing ownership could negatively affect AMRP management and operation, Liberty's Interim Audit Report found that [redacted]" ICC Staff Ex. 8.0, Attachment A at S-1. Importantly, [redacted]" *Id*. at 3-4, 5, 13. However, given the Joints Applicants' stated intention to completely alter both PGL and parent company management of AMRP (and later confirmation of a completely new management structure), these individuals are likely to be replaced (and some have been replaced) as senior management in the proposed reorganization. Tr. 216:9-14 (Leverett). Critically, Liberty also noted that [redacted]. ICC Staff Ex. 8.0, Attachment A at 3-4, 5, 13. The Joint Applicants have made no such commitments.

Without action by the Commission in this proceeding, ratepayers risk, at the least, [redacted]. ICC Staff Ex. 8.0, Attachment A at 2. Liberty's auditors also noted "[redacted]" ICC Staff Ex. 8.0, Attachment A at 10. Without Commission action to [redacted]. is unlikely to result in the protection of PGL's ratepayers interests.

ICC Staff Ex. 8.0, Attachment A at 3-4; City/CUB Ex. 9.0 at 59-78. If the ICC fails to act, an out-of-state entity with no AMRP transition plans, little relevant experience, few firm commitments of any sort, and no committed funds for AMRP implementation improvement would suddenly find itself in charge of a twenty-year program that "[redacted]." Staff Ex. 8.0, Attachment A at 4.

In fact, the pendency of this proceeding itself already has affected the management and operation of AMRP, and not for the better. Liberty's auditors noted that current [redacted]" Staff Ex. 8.0, Attachment A at 2, 10.

Regarding the ability of the organization component that would lead AMRP after a reorganization to effectively manage and operate AMRP, Liberty's auditors concluded that:

[redacted]

Staff Ex. 8.0, Attachment A at 14. After a reorganization, that organization would have less control over AMRP budget and funding decisions. JA March 18, 2015 Response to Commissioners' Data Request at 3; Tr. 137 (Schott).

As Mr. Cheaks concluded, "[t]he Audit Report provides strong, unsolicited, and independent support for imposing conditions regarding AMRP performance as a condition of any approved reorganization." City/CUB Ex. 9.0 at 22-24. If the Commission fails to act on the Audit Report in this proceeding, it may have to wait until 2020 for the next PGL or NS rate case before it has the opportunity to act on the cost and service implications of PGL's response to that report. City/CUB Ex. 9.0 at 24-27. The AG's witness Ms. Coppola similarly concluded that a "lack of commitment between now and the time that WEC receives a Commission decision or closes on the Reorganization will likely have a detrimental impact on the operation, safety, and rates of Peoples Gas." AG Ex. 6.0 at 98-100.

To allay these concerns, the Joint Applicants have half-heartedly endorsed the ongoing process of improving AMRP. Their half-hearted promise begins with the qualifier that "while they are in their initial stages and subject to revisions and refinements, Wisconsin Energy intends to fully support [redacted] after the approval and close of the proposed Reorganization." JA Ex. 14.0 at 27-30. WEC's stated intention to [redacted] contradicts their previous dismissal of proposed board of director conditions on the basis that PGL's parent company has no substantial role in AMRP. JA Ex. 6.0 at 498-518, 751-766. A similar contradiction with previous Joint Applicant positions can be found in WE's agreement with Liberty for the [redacted] and the stated need for WEC's Board to "allow effective oversight

of how [AMRP is] being managed and progressing." JA Ex. 12.0 at 188-194. Already, Mr. Schott stated he does not agree with some of the findings of the Interim Audit Report. Tr. 91 (Schott). This cannot give the Commission confidence that its' chosen auditors' report will be acted upon by PGL's new owners with the speed and commitment needed to avoid additional dysfunction in PGL's AMRP performance.

Similarly, WEC agrees that [redacted] is reasonable, but there is no commitment to do so. JA 12.0 at 48-51; 211-216. As Liberty auditors recommended and Mr. Cheaks concluded, these changes to the AMRP management structure are "necessary to ensure that Illinois ratepayer rate and service interests are protected going forward," and should be explicit conditions of any approved reorganization. City/CUB Ex. 10.0 at 71-75.

Mr. Leverett continues to believe that "the present proceeding is neither the time nor place for the AMRP itself to be evaluated or substantive fixes crafted and implemented." JA Ex. 15.0 at 232-234. This is because Mr. Leverett believes that AMRP problems are not related to the proposed reorganization, but are simply "operational issues that should be addressed regardless of Peoples Gas' ownership." JA Ex. 15.0 at 201-206. First, this fails to acknowledge that AMRP issues are not merely operational, and implicate fundamental management decisions, as established in detail above. Second, if the ICC declines to craft and implement conditions to improve AMRP performance, then it cannot reasonably find that service "will not" be impaired. Moreover, the Commission may not have the opportunity to use its authority to enforce prudence and reasonableness until the next rate case, which could be initiated years from now and would, in any event, be entirely at the option of the utilities. Third, this position ignores the evidence

from independent auditors that the proposed change in ownership [redacted] on AMRP implementation.

2. The Commission Must Impose Conditions to Ensure Safe, Adequate, Reliable, and Least-Cost Service

WEC's AMRP Commitments Do Not Support a Finding that the Proposed Reorganization Will Not Diminish PGL's Ability to Provide Adequate, Reliable, Efficient, Safe and Least-Cost Public Utility Service

The Joint Applicants admit that they have not proposed any quality of service improvements as part of the proposed reorganization. CUB Cross Ex. 1 (JA-City 2.29). It is unclear from their supplemental testimony if the JA agree to implement the Interim Audit Report's recommendations for [redacted]. City/CUB Ex. 10.0 at 11-12. Especially given the Interim Audit Report's conclusion that [redacted], the Commission has clear factual and legal bases for imposing requirements that assure the continued improvement and operation of AMRP. City/CUB Ex. 10.0 at 15-19.

Although Wisconsin Energy states that it "intends to fully support" the [redacted], the testimony does not specifically address the need for changes in the [redacted]. In response to Mr. Cheaks' recommendation that PGL agree to participate in CDOT's new dotMaps website, the Joint Applicants could only commit to "continue to investigate" its participation in a process that can reduce costs for PGL, CDOT, and other users of public rights of way. Participation in this process will allow PGL to more effectively and efficiently comply with CDOT's regulations, to identify conflicts to minimize unnecessary or wasteful costs, and possibly to alleviate concerns raised by PGL. City/CUB Ex. 7.0 at 231-247. For the price of less than one degradation fee (which the Joint

Applicants confirmed that PGL collects from Illinois ratepayers), PGL could access and provide information that could facilitate coordinating work with other occupants of the Public Way. City/CUB Ex. 7.0 at 231-247. The additional costs that non-participation causes the City are unfairly imposed, and the additional costs to PGL are not necessary or prudently incurred. City/CUB Ex. 7.0 at 231-247. Though the Joint Applicants have not rejected the dotMaps condition out of hand, they should be required to commit.

City/CUB's AMRP Conditions are Required for the Commission to Find that the Proposed Reorganization Will Not Diminish PGL's Ability to Provide Adequate, Reliable, Efficient, Safe and Least-Cost Public Utility Service

The record is replete with instances of poor AMRP management leading to construction problems. There are at least eight instances of where PGL's corrosion team submitted permits to the City without definite plans to begin construction on or near the starting date for the permit. JA Cross Ex. 1 (JA CC 2.69). There are at least 11 instances where PGL's lack of coordination has led to waste. JA Cross Ex. 1 (JA CC 2.71). The record also contains five instances where PGL's failure to timely schedule a construction crew wasted the window for coordinated cost-saving activity. JA Cross Ex. 1 (JA CC 2.72).

PGL's construction efficiency also differs between contract personnel hired to open and resurface Public Ways and those crews hired or employed to remove, install, or replace mains, pipes, and laterals. Liberty's auditors identified this area and recommended a specific solution, [redacted]" Staff Ex. 8.0, Attachment A at 14, 19.

WEC admits that "developing an integrated scheduling approach" appears reasonable and is likely to lead to an increase in efficiency for both AMRP and non-AMRP work. JA Ex. 13.0 at 132-134. This provides direct and further support for the dotMaps and schedule provision conditions Mr. Cheaks recommended in his direct testimony. The dotMaps website is a platform upon which PGL's AMRP and non-AMRP work can be integrated with the schedules for all other large construction projects in the City's Public Ways. City/CUB Ex. 10.0 at 88-93. Its' recommendation by Mr. Cheaks is paralleled by recommendations by Liberty's auditors to implement [redacted] Staff Ex. 8.0, Attachment A at 8, 12, 14-16, 6-8, 16-21.

The Joint Applicants concede that there are no present customer privacy concerns with implementing the dotMaps website. City/CUB Cross Ex. 1 (JA City 10.44). Moreover, the Joint Applicants concede that any data security concerns are alleviated by the fact that CDOT will be the owner of the subject data, as it is today. City/CUB Cross Ex. 1 (JA City 10.44). In order to ensure that PGL will be able to provide reliable, adequate, and least-cost service, the Commission should require PGL to participate in the dotMaps website and provide weekly block-by-block schedules.

B. Section 7-204(b)(2) -- no cross-subsidization of non-utility activities

The Commission must assess the protocols the Joint Applicants will have in place after the reorganization closing to track and account for tens of millions in transition costs and associated savings. The Joint Applicants expect that the Illinois utilities will have transition costs allocated to them if the reorganization is approved. Tr. 372 (Reed). Without a

demonstration that effective, detailed procedures that will be in operation from the closing, the Commission cannot be assured that costs will accurately be tracked and classified. Since the Joint Applicants only began to develop such protocols after prodding by City/CUB discovery and currently have only a sketch of working protocols (with major principles undecided (Tr. 474-5)), the record does not support Commission findings that there will be no cross-subsidization of non-utility activities and that costs, especially transition costs, will be properly allocated between utility and non-utility affiliates, for ratemaking purposes.

The difficulty of tracking and allocating transition costs as the Joint Applicants are considering and the Joint Applicants' lack of preparation for the task are discussed more fully below, in connection with the required Section 7-204(b)(7) finding.

C. Section 7-204(b)(3) -- fair allocation of costs for ratemaking

The Commission must assess the protocols the Joint Applicants will have in place after the reorganization closing to track and account for tens of millions in transition costs and associated savings. The Joint Applicants expect that the Illinois utilities will have transition costs allocated to them if the reorganization is approved. Tr. 372 (Reed). Without a demonstration that effective, detailed procedures that will be in operation from the closing, the Commission cannot be assured that costs will be accurately tracked and classified. Since the Joint Applicants only began to develop such protocols after prodding by City/CUB discovery and currently have only a sketch of working protocols (with major principles undecided (Tr. 474-5)), the record does not support Commission findings that there will a fair and reasonable allocation of costs, especially transition costs, between utility and non-utility activities for ratemaking purposes.

The difficulty of tracking and allocating transition costs as the Joint Applicants are considering and the Joint Applicants' lack of preparation for the task are discussed more fully below, in connection with the required Section 7-204(b)(7) finding.

D. Section 7-204(b)(4) -- no impairment of ability to raise capital

1. Impact of Reorganization Debt on Illinois Utilities

Section 7-204(b)(4) of the PUA prohibits the Commission from approving a reorganization if the Commission finds that it will (1) significantly impair the utility's ability to raise necessary capital on reasonable terms or (2) fail to maintain a reasonable capital structure. The financing structure of the Joint Applicants' proposed reorganization will result in a significant increase to the amount of debt at the parent company (to be known as "WEC Energy Group"). City/CUB Ex. 4.0 at 12:287-292. The financing plan accommodates the premium above prevailing book value that WEC agreed to pay to acquire Integrys' common stock. *Id*. at 13:305-308. WEC Energy Group will take on $1.5 billion of acquisition debt to fund the purchase. The cash to service that debt will come from its utility subsidiaries, including Peoples Gas and North Shore Gas. *Id*. at 13:309-314. The analysis of whether ratepayers are at risk of adverse rate impacts includes consideration of the utility's access to capital and its other obligations due to existing and future debt. *Ill. Consolidated Telephone Co.*, ICC Docket. No. 02-0502, Final Order of December 17, 2002 at 25-26.

Peoples Gas and North Shore Gas currently access capital markets on reasonable terms. Staff Ex. 7.0 at 4:70-81. Prior to the announcement of the proposed reorganization, Standard & Poor's ("S&P") had assigned the Companies an A- issuer rating (strong capacity to meet financial commitments, but somewhat more susceptible to adverse circumstances than higher rated entities), and Moody's Investors Service ("Moody's") had assigned the Companies an A1

issuer rating (upper-medium grade and subject to low credit risk). *Id*. However, following the announcement of the proposed reorganization in June 2014, S&P revised its forward-looking credit outlook for the Companies from "stable" to "negative." S&P cited expectations that "the incremental debt associated with this transaction will weaken WEC's financial measures," and indicated that the credit ratings of the Companies will be aligned with that of their new parent (WEC Energy Group). CUB Cross Ex. 3, JA MGM 1.15 Attach 02 at 3; 5-6; *see also* Staff Ex. 7.0 at 5:88-110. Fitch Ratings ("Fitch") had a similar response, placing WEC's ratings on "negative watch" following the merger announcement. CUB Cross Ex. 3, JA MGM 1.15 Attach 03 at 1. Fitch stated that the merger would result in a "meaningful increase in consolidated leverage compared to WEC's current and projected pre-acquisition financial position," and noted its additional concern about the "aggressive dividend policy adopted by management." *Id*. Fitch added that it "expects leverage metrics of the combined entities to be weak for the current rating category and significantly weaker than WEC's stand-alone credit profile." *Id*. at 2.

Staff witness Mr. McNally stated that it is, if not likely, "certainly possible" that the Companies' costs of capital will increase because of the proposed reorganization. Staff. Ex. 7.0 at 9:183-185; *compare* 220 ILCS 5/7-204(b)(4) (requiring a finding that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure"). The lower credit ratings projected by S&P and Fitch will, all else equal, lead to higher debt costs for the Companies. *Id*. at 10:217-218. Higher debt costs would, in turn, lead to higher costs of both debt and equity. *Id*. at 10:218-219.

The Joint Applicants have not proposed any reorganization terms or conditions that would alter those cost of service (and rate) dynamics, or that would provide the statutory level of

protection to Illinois utility ratepayers. *See* JA Ex. 15.1 Rev.; 220 ILCS 5/7-204(b)(4); *also compare* 220 ILCS 5/7-204(b)(7) (requiring a showing that adverse rate impacts are "not likely"). The Joint Applicants' proposed financial commitments (viz., Commitments 27-34) do not provide the certainty ("will not") or low risk ("not likely") that the statute requires. Some of the proposed commitments impose vague restrictions of uncertain meaning and effect. *See* Commitment 27 ("to the extent they existed prior to the entry of the final order"); Commitment 28 and 29 (prohibitions on loans and guarantees, but only to "non-utility affiliates"). The others serve mainly to require that the Joint Applicants file reports or studies with the Commission. *See* Commitment 30 and 31 ("shall file"), 32 ("shall present"), 33 ("should . . . be presented"), and 34 ("shall be filed"). Since the Commission may be unwilling or unable to act in a timely manner to prevent the Section 7-204(b) harms noted, the required statutory findings depend on future independent actions of entities not involved in the reorganization, the threshold requirements for approval are not met.

Mr. McNally suggested that if the Commission does not adopt Mr. Gorman's proposed dividend restrictions, certain lesser conditions be adopted as backup conditions. Staff Ex. 13.0 at 6:127; Tr. 531-532 (McNally). Mr. McNally's proposed requirements are mainly of the reporting variety (with some affiliate shielding). He proposes that the Commission adopt these backup proposals to mitigate the effects of the debt burden resulting from the reorganization and possible downgrades of WEC's credit ratings on the Companies. Staff Ex. 7.0 at 10-11:234-246. Mr. McNally's proposed conditions have subsequently been incorporated in the Joint Applicants' slate of commitments. *Compare id.* at 10-11:321-246 and JA Ex. 15.1 Rev. Commitments 27-34. However, absent the clear, enforceable dividend payout restrictions recommended by City/CUB witness Mr. Gorman, those conditions are not enough to protect

Peoples and North Shore ratepayers from the risk of constrained funding for the planned material infrastructure investment that is critical to service reliability and safety, when dividends to the parent corporation are given priority because they are necessary for WEC to meet its material reorganization debt obligations. City/CUB Ex. 4.0 at 2-3:46-62, 22:522; City/CUB Ex. 8.0 at 10:202; Tr. 355 (Reed).

The most recent financial press available prior to the evidentiary hearing in this case, UBS Reports -- an equity analyst on which Joint Applicant witness Mr. Reed relies (Tr. 419:8-22, 430:17-22) -- considered the investment risks of WEC. In that report, dated February 12, 2015, UBS stated, with regard to the industry in general, "We expect cost-cutting and strategic planning to be a theme across both regulated and competitive companies… *We believe utilities with high parent leverage will disproportionately suffer, as they are unable to recoup from rising interest rates*." CUB Cross Ex. 2 at 2 (emphasis added). This analyst expectation directly applies to the proposed reorganization, as WEC intends to fund the reorganization transaction by significantly increasing its debt obligations at the corporate level and its only source of cash to service the acquisition debt will come from its utility subsidiaries (including Peoples and North Shore). City/CUB Ex. 4.0 at 12:290-292, 13:313-314. Mr. Reed agreed that interest rates are indeed expected to rise in coming years. Tr. 418:19-22. Thus, the warning from the UBS report applies here – where there is high parent leverage and rising interest rates. At worst, then, the Companies' ability to access capital on reasonable terms is likely to be negatively impacted. At best, cost-cutting measures that are harmful to the Companies' ratepayers appear inevitable.

There is real risk that the proposed WEC Energy Group will be forced to extract additional cash from its utility affiliates, above and beyond what has been proposed in this case, if cash flow is not realized as projected by the Joint Applicants. City/CUB Ex. 4.0 at 13:295-

299; City/CUB Ex. 8.0 at 13:261, 270. Aside from the negative impacts on the Companies' costs of capital, such additional withdrawals could negatively impact the Companies' ability to fund important capital projects, including critical system modernization and improvement plans. *Id*. at 299-301.

2. Dividend Payout Restrictions are Necessary, If the Reorganization Is Approved

If the reorganization is not denied based on Section 7-204(b)(4) because of the financial effects described above, or based on Section 7-204(b)(7) because of their derivative effects on customer rates, the protective conditions recommended by City/CUB expert Michael Gorman must be a part of any Commission approval. WEC's reorganization debt will create pressures that necessitate a dividend payout restriction to protect ratepayer interests, by ensuring that the Companies' system modernization programs are prioritized above the payment of dividends to the parent company to help cover reorganization debt.

WEC is a holding company, completely dependent for its debt coverage on the ability of its subsidiaries to pay amounts to WEC through dividends or other payments. City/CUB Ex. 4.0 at 14:316-321. WEC currently pays public dividends to its shareholders. Post-reorganization, WEC has indicated its intention to pay increased dividends per share at the same time that it will also have to pay the debt service (principal and interest) on the $1.5 billion of new reorganization debt. *Id*. at 333-336. If WEC requires its utility subsidiaries to pay up higher dividends to cover increased obligations, the cash flow available for those utilities' modernization investment and service operations is reduced. *Id*. at 15:348-349; also Tr. 133-134, 137 (Schott) (utilities do not dictate their own dividend policies, independent of their holding company). If the dividend payments from Peoples Gas, specifically, are increased, reduced funds available for PGL's

system investment could delay implementation of the necessary and Commission-required AMRP. *Id*. at 15:348-350.

Alternatively, as the Joint Applicants' Mr. Reed suggests (JA Ex. 8.0 at 20:398), Peoples could go to the market for external debt to fund AMRP. However, that alternative could erode their credit rating and increase its cost of debt. Such adverse effects on the utility's financial position would preclude satisfying the threshold Section 7-204(b)(4) requirements, and the resulting harm to the ratepayers who will have to pay increased capital costs in rates would violate the Section 7-204(b)(7) criterion. *Id*. at 15:351-352.

City/CUB witness Mr. Gorman assessed whether the projected level of dividend payouts from the utilities to WEC could support both WEC's increased dividend payouts and service on the reorganization debt service, under the proposed reorganization. Mr. Gorman compared the forecasted level of utility dividend payments up to WEC (post-merger) with the amount of cash WEC needs to (1) pay its public dividends and (2) service the $1.5 billion acquisition-related debt. City/CUB Ex. 4.0 at 362-366. WEC will also have to service parent company debt that existed prior to the merger, meaning that WEC's incremental reorganization debt service will have to be funded from new subsidiary payments. Even when Mr. Gorman's very conservative assessment left that consideration out of his analysis, thus understating the pressure on WEC's utility subsidiaries for cash flow, the analysis shows a persistent need to extract more in payments from the utilities. *Id*. at 15-16:366-370. Since the Commission cannot find that the proposed reorganization financing "<u>will</u> <u>not</u> diminish" the utilities' ability to meet its statutory service obligations, the proposal presents an unlawful risk that bars approval. 220 ILCS 5/7-204(b)(1) (emphasis added).

City/CUB Ex. 4.1 shows projected utility cash dividend payments to WEC Energy Group for the period 2015-2018. City/CUB Ex. 4.0 at 16:372-374. Mr. Gorman's analysis showed that WEC's planned dividend payments from utility subsidiaries up to WEC may not be adequate to pay planned increased shareholder dividends, service existing debt, and simultaneously service the $1.5 billion in reorganization-related debt. *Id*. at 16:381-384. Thus, Peoples and North Shore may be required to make increased dividend payments up to WEC, beyond what is currently contemplated under the proposed reorganization. *Id*. at 16:390-392. And those current dividend projections already assume that the Illinois utilities will pay out more of their earnings as dividends than they currently do—a projected total of 89% of their earnings. *Id*. at 17:406-409, 18:421-422. For PGL, that is in comparison to an average of 59% of their earnings over the past five years. City/CUB Ex. 4.1 at 1. That leaves less internal cash available to the Companies to support their own needs, such as critical capital investment programs, including AMRP. City/CUB Ex. 4.0 at 16-17:392-397.

Moreover, the danger of service-affecting cash extractions is greater for Illinois utilities than for other utility subsidiaries. As discussed above, S&P, Moody's, and Fitch have all remarked on the magnitude of WEC Energy Group's increased financial obligation following the merger, and on the fact that WEC Energy Group's only source of cash will be its utility subsidiaries. *Id*. at 18:430-432. However, the Public Service Commission of Wisconsin ("Wisconsin PUC") has the authority to restrict Wisconsin subsidiary utility payouts in the form of dividends if certain financial metrics are not met. *Id*. at 18-19:435-441. Illinois has no comparable regulatory mechanism in place. Fitch observed that the credit ratings of the Wisconsin utilities will be unaffected, since "[r]egulatory restrictions regarding upstream dividend distributions to WEC provide some level of credit protection and mitigate contagion

risk to the utilities from higher leverage at the parent." CUB Cross Ex. 3, Att. 03, p 1. As the ratings agencies have noted, WEC Energy Group's level of post-reorganization debt will be so great that under-performing projections will require more from the utility subsidiaries. *Id*. at 21:496-498. Thus, Illinois subsidiaries could be in the position of shouldering an even greater burden when Wisconsin subsidiaries and their customers are protected by dividend restrictions and -- absent Mr. Gorman's proposed reorganization approval conditions -- Illinois companies and customers are the principal remaining source of cash.

The Joint Applicants point to PUA Section 7-103 and their proposed commitments as factors that make Mr. Gorman's proposed dividend restriction unnecessary. The evidence shows that neither would actually protect Illinois utilities and ratepayers. The PUA statutory provision authorizing the Commission to limit the payment of dividends is not adequate to ensure that system improvements for safety and reliability are given higher priority than parent-company dividends. First, the Commission may order a utility to cease and desist payment of dividends only if the Commission finds that the capital of a utility has (effectively) already become impaired:

> No utility shall pay any dividend upon its common stock and preferred stock unless:
>
> (a) The utility's earnings and earned surplus are sufficient to declare and pay same after provision is made for reasonable and proper reserves.
>
> (b) The dividend proposed to be paid upon such common stock can reasonably be paid without impairment of the ability to perform its duty to render reasonable and adequate service at reasonable rates.
>
> (c) It shall have set aside the depreciation annuity prescribed by the Commission or a reasonable depreciation annuity if none has been prescribed.

220 ILCS 5/7-203(1), (2). If a wholly owned utility subsidiary is compelled to pay out dividends despite not meeting any of the above requirements, this provision become operative. Though the utility is required to give the Commission at least thirty days' notice if it plans dividends while under financial stress, no notice is required if the utility does acknowledge that the dividend would trigger the section 7-203 constraints. City/CUB 8.0 at 9:189. In either case, Staff's finance expert testified that the extraordinary assessment required to support a Commission order stopping the dividend payments would likely take longer than the brief period provided by the notice. Tr. 534 (McNally). In short, the PUA dividend restrictions only protect the financial integrity of a utility during specifically defined periods of financial distress, and even that protection may not be timely.

Under the PUA's provisions, Illinois utilities could meet the statutory requirements for avoiding Commission dividend constraints, but still not be able to pay the planned dividends and simultaneously meet their system investment needs. Under holding company pressure, a utility may choose to make a dividend payout (or an increased dividend payout) rather than meet its full obligations to make capital improvements that enhance safety and reliability. City/CUB Ex. 8.0 at 10:195-202. As Mr. Gorman explained:

> The PUA dividend restriction is based on whether or not there are adequate earned surplus or retained earnings to permit the utility to pay dividends. This is a far different standard than receiving a bonafide assurance from the Joint Applicants that meeting their system modernization capital program will have a higher priority than making dividend payments up to WEC. This is particularly important since WEC will be taking on additional significant financial obligations as a result of its funding sources for the proposed transaction.

City/CUB Ex. 8.0 at 9:180. The statutory dividend provisions provide ratepayers far less protection than Mr. Gorman's proposed dividend payout restriction.[5] Indeed, they provide no assurance that programs like the AMRP will have a higher priority than dividend payments up to WEC Energy Group.

The Joint Applicants also suggested that their proposed commitments make Mr. Gorman's proposal unnecessary. The Joint Applicants' financing experts identified those commitments as the proposed AMPR commitments, "most specifically Commitment No. 5." However, the proposed Commitment No. 5 is a conditional, unmeasurable promise to "continue the Accelerated Main Replacement Program ("AMRP"), assuming it receives and continues to receive appropriate cost recovery." JA Ex. 15.1 Rev. The Joint Applicants' quantified investment commitment must cover not only PGL's AMRP, but all other investment requirements as well. Moreover, the funding commitment would last for only three years of the decades of investment and construction required to complete PGL's AMRP project.

In light of the above circumstances, City/CUB witness Mr. Gorman suggested "ring-fence protections," also known as "dividend payout restrictions," to assure that utility cash flows will be used to avoid diminished utility service first, before dividends to serve parent company financial obligations. Specifically, Mr. Gorman recommended that dividend payouts of Illinois utilities should be restricted if Illinois utilities do not fulfill their obligations (both in amount and as to timing) to make capital improvements to their distribution systems. City/CUB Ex. 4.0 at 21-22:517-522, City/CUB Ex. 8.0 at 7:142-145. This would ensure prioritization of the

[5] The PUA's provisions also provide less automatic protection to Illinois ratepayers than Wisconsin ratepayers will enjoy. There is no reason Illinois ratepayers should have less protection than Wisconsin ratepayers in this reorganization. The Commission has the authority to equalize this risk to ratepayers by adopting Mr. Gorman's dividend restriction as a condition of any approval.

Companies' ability to fund capital programs, which enhance system safety and reliability, above funding the acquisition-related debt created by this proposed reorganization. City/CUB Ex. 4.0 at 22:522-526. Otherwise, Illinois ratepayers will be less protected from the effects of this proposed reorganization than Wisconsin ratepayers, and less protected than they are currently. *Id*. at 22:526-528.

Staff witness Mr. McNally took no position on Mr. Gorman's proposal in his written testimony. He agreed, however, that Section 7-103 of the PUA is not preemptive, and thus recommended that, if Mr. Gorman's proposal is not adopted by the Commission, the Commission should require the Joint Applicants to file copies of all credit agency reports for NS and PGL and WEC Energy Group with the Commission within five business days of publication "so that the Commission can act on its authority under 7-103 in a timely manner." Staff Ex. 13.0 at 6:127-134. Section 7-103 does not require that the utility provide the Commission with advanced notice of its intention to declare and pay a dividend (220 ILCS 5/7-103), and generally does provide notice that a utility is in fact going to declare and pay a dividend until that information has been made public. Tr. 532. At that time, it is likely too late for the Commission to act on its 7-103 authority to prohibit payment of dividends. Mr. McNally's proposal provides no assurance that the Commission will learn of the financial impairment of a utility until dividends have already been paid, and there is no recourse at that point. Mr. McNally's alternative condition does not provide nearly the level of ratepayer protection as Mr. Gorman's proposal.

As a condition of any Commission-approved reorganization, funding for the Companies' capital programs should be prioritized over dividend payments up to WEC Energy Group, in a clear commitment with defined and enforceable consequences for violation. This condition will

act as insurance to protect customers, in the event the expected outlook for the Joint Applicants' cash flows and ability to fund capital improvement plan are weaker than forecasted by the Joint Applicants. City/CUB Ex. 8.0 at 11:231-234. To the extent that the Companies' obligations regarding system modernization capital programs are not met, the Companies' dividend payouts should either be limited or eliminated. The safety and reliability of the Companies' distribution systems should be prioritized over dividend payouts to the out-of-state parent company.

E. Section 7-204(b)(5) -- remain subject to Illinois utility laws and policies

Consistent with the requirements of the statue, the Commission has given substantive meaning to this provision and used laws and policies encompassed by it to attach conditions to a reorganization approval. For instance, in *Re Fairpoint Communications,* ICC Dkt. No. 04-0299, Final Order of May 26, 2004, the Commission gave effect to the service quality policies of the Commission and the utility. Staff recommended and the Commission agreed that the circumstances of the case justified the Commission's imposition of both conditional dividend restrictions (due to "the high degree of financial leverage" at the holding company) and service quality metrics that would activate dividend restrictions to protect funds for operations. *Re Fairpoint Communications,* ICC Dkt. No. 04-0299, Final Order of May 26, 2044 at 8, 12.

The circumstances in this case are comparable, if not more compelling, and warrant imposition of similar approval conditions, as City/CUB experts Michael Gorman (dividend restrictions) and William Cheaks (AMRP performance metrics) have recommended. The bases for their recommendations are explained in the portions of this brief relating to Sections 7-204(b)(4) and 7-204(b)(1).

1. Energy Efficiency Conditions Are Necessary, If the Reorganization is Approved

Under Section 7-204 of the PUA, the Commission has conditioned approval of a reorganization on the commitment of PGL and NS to propose $7.5 million of energy efficiency programs. *WPS Resources Corp., Peoples Energy Corp., The Peoples Gas Light and Coke Co., and North Shore Gas Co.*, ICC Dkt. No. 06-0540, Final Order of February 7, 2007 at 24. In *WPS*, the previous reorganization case that created Integrys Energy Group, the Commission conditioned approval based on a requirement that PGL and NS "specify the details of the energy efficiency program(s), and agree to begin to work immediately together and with other interested parties in good faith" and that "a third-party administrator should implement the energy efficiency program(s)." *Id*. at 25.

The Commission has also conditioned approval or a reorganization on a requirement that the subject utilities ensure certain specific funding levels for energy efficiency. *Central Ill. Public Service Co., Union Electric Co.*, ICC Dkt. No. 03-0657, Final Order of September 22, 2004 at 21. The ICC has also issued its own report making clear that the Commission has an active role, even in non-EEPS proceedings, to contemplate the effect on energy efficiency of its various orders. *See* ICC Report to the General Assembly Concerning Coordination Between Gas and Electric Utility Programs and Spending Limits for Gas Energy Efficiency Programs, August 30, 2013. Under subsection 7-204(b)(5), the Commission is required to find that PGL and NS will remain subject to applicable decisions and policies such as those recounted above. 220 ILCS 5/7-204(b)(5). In addition, the Commission is authorized to impose conditions that it finds are necessary to protect the interests of PGL and NS ratepayers. 220 ILCS 5/7-204(f).

Here, City/CUB submitted testimony from Ms. Karen Weigert, Chief Sustainability Officer of the City of Chicago. Ms. Weigert guides the City's sustainability strategy and implementation to bring innovative, practical solutions to improving energy efficiency and

encouraging innovation in the generation, distribution, and consumption of energy. City/CUB Ex. 2.0 at 21-25. As a condition of any approved reorganization, the Commission should require:

- an additional contribution of $10 million in energy efficiency programming funded by Wisconsin Energy's shareholders
- changes to PGL and NS's On Bill Financing programs to allow more ratepayers to access the program and to fund a greater number of measures
- the creation and maintenance of an electronically accessible energy use database for aggregated, building-level energy use
- the creation of an updatable database of actual usage patterns for all ratepayers of PGL and NS; and
- the issuance of a public report examining the costs and benefits of implementing energy efficiency programming through a third party.

City/CUB Ex. 3.0 at 40-53.

The Joint Applicants only committed to "work with interested stakeholders to develop recommendations." This commitment is too vague and unenforceable to have substantive meaning for PGL and NS ratepayers. Ms. Weigert explained that "more certainty is needed, as the decision making for the utilities' energy efficiency programming moves farther from the affected ratepayers." City/CUB Ex. 2.0 at 58-60. It appears that the Joint Applicants do not see energy efficiency as being in the interests of the utilities' ratepayers, otherwise they would agree to concrete improvements in PGL and NS energy efficiency programming. City/CUB Ex. 6.0 Rev. at 47-49. The only way to assure the Commission and Illinois ratepayers that this "concerted effort" will materialize into clear favorable results is a Commission requirement to make such expansion permanent. Any gains made through stakeholder involvement with current management are at risk with new, out-of-state management.

a. The Commission Should Require Wisconsin Energy's Shareholders to Contribute $10 Million in Energy Efficiency Funds to Protect the Interests of PGL and NS Ratepayers

Currently, PGL and NS are allowed to charge ratepayers amounts up to a specific cap, called the energy efficiency portfolio standard ("EEPS"). 220 ILCS 5/8-104. The EEPS is intended to "reduce direct and indirect costs to natural gas consumers." 220 ILCS 5/8-104(a). Although the General Assembly has authorized PGL and NS to implement energy efficiency measures that save a specified number of therms each Program Year, the latest order approving PGL and NS plans allows them to pursue programs that save less than the statutory goals, even though both utilities continue to collect the full statutory amount of ratepayer funds authorized by the General Assembly. *North Shore Gas Co. and The Peoples Gas Light and Coke Co.*, ICC Dkt. No. 13-0550, Final Order of May 20, 2014 at 7. Ms. Weigert concluded that PGL and NS can achieve greater savings, even within the budget constraints of the legislation. City/CUB Ex. 2.0 at 75-77. Currently, PGL and NS ratepayers are paying full price for delivery of less than the full measures of product than the legislature intended.

PGL's EEPS budget will decline by approximately 9.5% between the previous three-year plan and the one covering 2014-2017. City/CUB Ex. 2.0 at 89-90. Although Ms. Weigert acknowledged that much of the "low-hanging fruit" has been picked, she also noted that PGL's and NS's rate increases offer little if any decrease in end-user natural gas costs, despite generally lower natural gas prices. City/CUB Ex. 2.0 at 90-96. WEC has shown that it chooses to impose higher fixed charges where it can, thereby reducing the costs avoidable by customers who conserve. City/CUB Ex. 6.0 Rev. at 39-41. The decrease in EEPS funding means that there are fewer dollars available to implement measures that reduce PGL and NS ratepayer costs. Ms. Weigert also noted the loss of approximately $50 million in non-EEPS funding for energy efficiency programs for PGL and NS ratepayers. City/CUB Ex. 2.0 at 102-105. Moreover, Ms. Weigert testified that PGL's ratepayers have faced a 200% increase in their fixed charge in

recent years, making it difficult if not impossible for PGL and NS ratepayers to reduce their bill *even if* they take advantage of all energy efficiency programming available to them -- with disproportionate impacts on low and moderate income ratepayers. City/CUB Ex. 2.0 at 107-118.

The proposed reorganization "presents the possibility that the excess of ratepayer contributions over delivered utility programs will become just another revenue stream flowing out of Chicago to the proposed acquiring company." City/CUB Ex. 2.0 at 122-124. Ms. Weigert noted that PGL's ratepayers already have paid for more than PGL has provided. City/CUB Ex. 2.0 at 124-125. To protect ratepayers against this possibility, Ms. Weigert recommended a condition that the Joint Applicants' shareholders fund $10 million of new energy efficiency programming. City/CUB Ex. 2.0 at 128-130.

Currently, once the utilities attain the Energy Efficiency Portfolio Standard ("EEPS") goals (as reduced by the Commission), if they have additional funding available, it is *discretionary* whether to use those funds to achieve additional savings and how to achieve those additional savings. City/CUB Ex. 6.0 Rev. at 56-59. In fact, PGL has exercised that discretion to stop funding energy efficiency programming once a reduced goal was met. City/CUB Ex. 6.0 Rev. at 59-61. Given the magnitude of dollars at issue, Ms. Weigert concluded that it is likely that new ownership would be making these determinations that would directly affect the utilities' rates -- either by denying savings opportunities or incurring additional EE costs. City/CUB Ex. 6.0 Rev. at 61-64.

Simply removing a disincentive to reduce gas consumption (e.g. through imposition of Rider VBA) does not provide an affirmative incentive for the utility to act within its discretion to reduce gas consumption. City/CUB Ex. 2.0 at 65-66. Even with Rider VBA intact, the Joint Applicants have not rebutted the fact that demand drives additional investment in the gas

distribution infrastructure on which the utility earns a mandated return. City/CUB Ex. 6.0 Rev. at 158-161. And even if Rider VBA achieved full decoupling, removing a disincentive against lowered consumption is not the same as incentivizing additional energy efficiency savings. City/CUB Ex. 6.0 Rev. at 163-167. Additionally, using shareholder funds avoids the barriers associated with some EEPS programming under Section 8-104, allowing for a more complete range of measures to be funded. City/CUB Ex. 2.0 at 130-132. Despite the success of many of the existing EEPS programs, PGL and NS ratepayers should not be asked to shoulder even more payments when their EEPS funding is not returning the savings contemplated by the General Assembly.

Despite the commitment made by PGL and NS in *WPS*, PGL's delivery service rates have risen by 65% since that commitment while PGL's budget for EEPS funding has fallen by almost 10%. City/CUB Ex. 2.0 at 141-145. Over the same period, non-EEPS funding has fallen even further. Inflation alone is (cumulatively) at approximately 15% over that timeframe. Thus, the commitment made during PGL's last reorganization has proved to be worth very little to PGL's ratepayers. Ms. Weigert explains that is because the costs for the $7.5 million worth of energy efficiency programming were collected from PGL and NS ratepayers, rather than an incremental injection of energy efficiency savings from an outside entity. City/CUB Ex. 6.0 Rev. at 147-149. The record contains no indication that Wisconsin Energy, after approval of a reorganization, will be more inclined (than PGL has been) to honor the aims of Section 8-104 and use all the funds collected from PGL ratepayers for effective programs to reduce energy use and to lower bills.

b. The Commission Should Require PGL and NS to Allow More Low and Moderate Income Ratepayers to Benefit from On-Bill Financing

PGL's On Bill Financing Program ("OBF"), was established in 2011, when PGL earmarked $2.5 million for program. City/CUB Ex. 2.0 at 269. One goal of the program is to enable a new pool of consumers – many of whom may not otherwise have access to financing – to take advantage of energy efficient products and technologies that have significant upfront costs. *North Shore Gas Co. and The Peoples Gas Light and Coke Co.*, ICC Dkt. No. 10-0090, Final Order of June 2, 2010 at 32. Currently, PGL only allows three energy efficiency measures to be eligible for OBF. City/CUB Ex. 2.1 (JA DRR to City 5.05). PGL has financed approximately $492,403.70 through the OBF program and has lost $3,453.50 in OBF loan revenues, representing a loss of only 0.992 percent of the total amount financed. City/CUB Ex. 2.1 (JA DRR to City 5.05, 5.06). No Rate 2 customers have qualified for loans through OBF. City/CUB Ex. 2.1 (JA DRR to City 5.05). The Commission has already recognized the fact that these loans hold little to no risk for PGL, as the negligible loss actually experienced confirms. ICC Dkt. No. 10-0090, Final Order at 32.

PGL plans to expand the availability of OBF programs to residential and multifamily weatherization measures, including air sealing. City/CUB Ex. 2.0 at 283-285. Nevertheless, low participation has been a problem for PGL's OBF program. The Commission has indicated that it shares the concern around low participation and looks forward to ways to address that problem. *Ill. Commerce Comm'n On Its Own Motion*, ICC Dkt. No. 11-0689, Final Order of May 15, 2013 at 7. Potential participants may be deterred by the use of credit history as an eligibility criterion, especially since the population targeted by the OBF program (those for whom initial upfront costs of energy efficiency equipment deter participation in the market for energy efficiency measures) generally have lower credit scores than the average market participant. City/CUB Ex. 2.0 at 291-295. The higher credit scores required by PGL may mean that there are

fewer customers with lower-credit scores utilizing OBF, and few incremental users of energy efficiency equipment, since customers with higher credits scores likely have access to other sources of financing. *Id*. at 295-298.

Potential participants may also be deterred by the limited number of measures currently eligible for OBF. *Id*. at 299-300. The General Assembly has expressed its intent to allow any measure that is approved as part of PGL's EEPS to be eligible for the OBF program. Public Act 98-0586 (Aug. 27, 2013). Ms. Weigert noted all of the currently OBF-ineligible measures that are part of the utilities' EEPS, such as attic and wall insulation, tankless water heaters, pipe insulation, duct sealing, air conditioner replacement, and stream traps. City/CUB Ex. 2.0 at 302-305.

The ICC has recognized the goal of making the eligibility screens more inclusive for OBF, stating that "the Commission does not want the program to exclude customers who could benefit from energy efficiency measures because they do not meet traditional credit standards." ICC Dkt. No. 10-0090, Final Order at 32. Given the extraordinarily low rate of loss (less than 1 percent), PGL's OBF program should be expanded to include those ratepayers who may not qualify based on their credit history but may qualify based on their bill payment history. City/CUB Ex. 2.0 at 311-314. Ameren Illinois Company is already attempting to implement this method of eligibility screening. *Id*. at 314-315. Despite their protestations, the Joint Applicants agree that, even under their current contract with the OBF financier, PGL and NS "could seek to change the financing entity for its On-Bill Financing … program, as the current agreement can be terminated for convenience on 30 days' notice and payment of all note loan obligations." JA Ex. 4.1 (JA DRR to City 10.27). Even with the current financier, Ms. Weigert's experience suggested that it is the utility that provides any credit score used in the Loan Underwriting

Guidelines and not the financier. City/CUB Ex. 6.0 Rev. at 134-136. Moreover, even under the contract with the current financier, Joint Applicants have, in fact, changed the list of measures that are eligible to be financed, suggesting that credit score eligibility criteria could also be changed. City/CUB Ex. 6.0 Rev. at 137-139. Finally, the Joint Applicants admitted that the current financier is also contracting with Ameren Illinois, who is known to be piloting the use of bill payment history rather than credit scores. City/CUB Ex. 6.0 Rev. at 140-144. That should provide PGL and NS more than enough precedent to request the changes Ms. Weigert recommended.

In order to provide the greatest number of cost-effective choices possible to potential OBF participants, PGL's OBF program for both single family and multifamily participants should explicitly include all measures that are part of PGL's EEPS. City/CUB Ex. 2.0 at 316-318. These programs have already been found to be cost-effective by the ICC. It makes little sense to finance a boiler upgrade if a home also needs attic insulation or other forms of weatherization. *Id*. at 319-321. In order to attract more participants, and in order to maximize the effectiveness of the measures and resulting savings that can be offered by financed energy efficiency measures, PGL's OBF program should consider all EEPS measures eligible for financing.

c. The Commission Should Require PGL to Offer its Ratepayers an Automated, Aggregated Energy Use Database and a Comprehensive Database on Energy Usage

Energy usage data can deliver value to City residents by providing information about reducing energy usage, targeting economic development opportunities, and studying the need for and efficient delivery of customer assistance programs. City/CUB Ex. 2.0 at 221-224. In addition, usage data can be essential for compliance with the City's Building Energy Use

Benchmarking Ordinance ("Ordinance"), City of Chicago Municipal Code Chapter 18-14. Under this ordinance, covered building owners must report certain aggregated energy usage information to the City. City/CUB Ex. 2.0 at 228-229.

One tool that building owners can use to comply with the Ordinance is Commonwealth Edison Company's Energy Usage Data System ("EUDS"). City/CUB Ex. 2.0 at 230-232. The EUDS provides building owners with an easy, online, automated way to obtain aggregated usage information regarding their buildings. *Id*. at 231-233. Without the EUDS tool, building owners could face significant threshold costs merely to evaluate the efficiency of measures installed in their buildings. *Id*. at 234-236. While PGL created a system earlier this year to offer basic aggregate energy usage data for buildings, it is only partially automated and does not offer the year round functionality of ComEd's EUDS. *Id*. at 236-238. The manual process in place today, which requires a user to wait up to a week for data, requires input, time, and effort of actual personnel. City/CUB Ex. 6.0 Rev. at 172-174. As the City's Benchmarking Ordinance expands over time to cover hundreds of additional buildings in 2015 and 2016, Ms. Weigert noted that the manual processes will become even more resource intensive. City/CUB Ex. 6.0 Rev. at 176-178.

In contrast, an automated system would eliminate much of that time and effort. City/CUB Ex. 6.0 Rev. at 178-179. Furthermore, the manual system does not truly offer building-level gas use aggregation, as required by the City's Benchmarking Ordinance but instead aggregates usage for multiple accounts served by the same natural gas service pipes such that buildings served by multiple pipes face an additional task. *Id*. at 180-182. Finally, ComEd has implemented an automated process that integrates with the ENERGY STAR Portfolio Manager (a recognized industry-standard tool for energy performance tracking and reporting used in 10 different cities) and, without one for PGL, it will be harder for regulated entities to

comply with the City's ordinance, a burden that can be lessened or removed with a commitment to implement an automated solution. *Id*. at 182-187.

In addition to the usage data gathered in compliance with the Ordinance, the City has also developed a database to analyze Chicago's energy usage (both gas and electric) on a block-by-block basis. City/CUB Ex. 2.0 at 239-241. This data has been used by the City to evaluate expenditures and design of outreach for energy efficiency programs. City/CUB Ex. 2.0 at 241-242. Ms. Weigert noted that detailed data, such as the usage data used for this portal, is required for any successful research program, especially those which seek to improve the savings received from energy efficiency and dynamic pricing programs. City/CUB Ex. 2.0 at 247-250. This type of data is crucial to answering research questions regarding housing characterization studies, understanding how local conditions vary from national averages, and to effectively coordinate gas and electric energy efficiency programs. City/CUB Ex. 2.0 at 250-253.

The Joint Applicants should be required to offer a ComEd EUDS-like system to access aggregated natural gas usage data for buildings that is fully automated, timely, and offers billing quality data and which includes full technical support. City/CUB Ex. 2.0 at 256-257. In addition, the Joint Applicants should be required to work with the City and its academic research partners to create an ongoing, updatable database of actual natural gas usage data that protects the privacy of ratepayers. *Id*. at 262-264. Without these databases, PGL and NS expenditures on energy efficiency will not lead to the maximum savings possible.

d. The Commission Should Require Wisconsin Energy Shareholders to Study the Costs and Benefits of Third-Party Administration of PGL and NS Energy Efficiency Programs

Wisconsin Energy administers its energy efficiency programs through a third party called Focus on Energy Wisconsin. City/CUB Ex. 2.0 at 180-181. Like Efficiency Vermont, which is

run by a private nonprofit organization called Vermont Energy Investment Corporation, this third party administrator does not have the same incentive conflicts that utilities have. *Id*. at 183-185. This model allows a third-party administrator, instead of the utilities, to make programmatic and strategic decisions affecting which measures are deployed and how much funding is used. Despite the incessant march towards higher and higher fixed monthly charges, utilities' interests are still benefitted by increased throughput. *Id*. at 187-189. The third party administrator model thus, theoretically, removes this overarching disincentive and allows the administrator to champion and implement programs that will be successful in reducing overall energy use. City/CUB Ex. 2.0 at 189-191. A third-party administrator would maximize reductions in energy use, would align closely with the common goals defined by the General Assembly for the gas EEPS and the recent decisions of the ICC to encourage greater energy efficiency. *See* 13-0550 Final Order at 26-27, 64.

The Commission should investigate the possibility of implementing a solution Wisconsin has used to respond to the incentive conflicts noted above. City/CUB Ex. 2.0 at 202-204. In order to explore an alternative way to spend dollars more effectively on energy efficiency, despite PGL and NS incentives, the Commission should order that that the Joint Applicants fund a study of the potential costs and benefits of third party administration of PGL and NS EEPS programs. *Id*. at 205-210. Illinois ratepayers deserve no less than Wisconsin ratepayers in terms of effective energy efficiency initiatives.

F. Section 7-204(b)(7) -- adverse rate impact not likely

The statutory issue the Commission must address pursuant to this subsection is broader than the level of rates. The Commission must examine factors that are unaffected by a proffered rate case moratorium or artificial sweeteners added to a reorganization proposal.

> The fundamental requirement for a rate is that it must be just and reasonable, and a proposed rate change must also be just and reasonable. A rate must also be non-discriminatory, and, as discussed above, it cannot, per Section 9-230, reflect capital costs associated with non-regulated affiliates. Accordingly, a merger proposal that would likely render a rate unjust, unreasonable, discriminatory or infused with prohibited capital cost is adversely impacting that rate within the meaning of subsection 7-204(b)(7), irrespective of whether the rate will increase.

Nicor Merger at 29. As the Commission also held, "a merger proceeding involves a change of ownership, not ratemaking." *Id.* The issues in this proceeding are simply not matters of addition and subtraction, but may be affected as well by factors like unreasonable uncertainty in cost determinations, inclusion of imprudent costs, and capital transactions that compromise a utility's service capabilities. The adverse rate impacts that have been identified in this brief have various sources, but their rate impacts preclude approval of the proposed reorganization.

1. Rate Recovery of AMRP Management Inefficiency Costs

The PUA requires the Commission to ensure that a proposed reorganization will not result in adverse impacts for PGL's ratepayers, and it has ample authority to do so. 220 ILCS 5/7-204(b)(7), (f). "Subsection 7-204(b)(7) obliges the Commission to determine whether the proposed reorganization will likely result in an adverse retail rate impact in subsequent rate proceedings." *Nicor Merger* at 30. To protect ratepayers from adverse rate impacts when reorganizations were approved, the Commission has imposed a wide range of circumstance-based conditions on its approval.

In the *Nicor Merger*, the Commission imposed conditions to ensure that "insofar as jeopardy to [the utility's] financial integrity is the result of imprudent or unreasonable action or inaction by [the utility] or its affiliates, the Commission undertakes no commitment here to

requiring ratepayers, rather than shareholders, to bear the costs of easing that jeopardy." *Id*. at 31. In another case, the Commission relied on utility commitments to establish penalties for failure to realize benefits from the proposed reorganization. *Ill. Power Co. and Ameren Corp.*, ICC Docket No. 04-0294, Final Order of September 22, 2004 at 22. The Commission has also relied on utility commitments to transfer assets in the event of certain rate of return on common equity triggers that could be exceeded post-reorganization in approving conditions for reorganization under Section 7-204(b)(7). *Central Ill. Public Service Co., Union Electric Co.*, ICC Docket. No. 03-0657, Final Order of September 22, 2004 at 15-17. The analysis of whether ratepayers are at risk of adverse rate impacts includes consideration of the utility's access to capital and its other obligations due to existing and future debt. *Ill. Consolidated Telephone Co.*, ICC Docket. No. 02-0502, Final Order of December 17, 2002 at 25-26. In applying subsection 7-204(b)(7), the Commission has imposed, as a condition of an approved reorganization, a specific percentage of revenue requirement increase allowed as a result of demonstrated savings pursuant to a specific methodology for quantifying savings. *Ill.-American Water Co., Citizens Utilities Co. of Ill. and Citizens Lake Water Co.*, ICC Docket No. 00-0476, Final Order of May 15, 2011 at 44-45.

If the proposed reorganization is approved, protecting PGL's ratepayers from adverse rate impacts would require that Chicago's ratepayers alone do not bear the burden of funding an inefficient, wasteful, and mismanaged program proposed to be taken over by a plan-less out-of-state entity unwilling to commit to substantive improvement in the program and with little to no experience managing a program the size and complexity of AMRP. WEC proposes to revive for PGL the condition that Rider QIP was intended to remove, funding uncertainty. In addition, WEC proposes to condition AMRP performance and completion on "appropriate cost recovery,"

including the continued availability of Rider QIP and its incessant rate increases and rate-impact cap resets.

This is problematic for the Commission's statutory finding that the proposed reorganization would not result in adverse rate impacts for PGL's ratepayers. As Mr. Cheaks noted, "the poor level of performance in PGL's construction activities themselves has immediate cost consequences for PGL ratepayers and for Chicago taxpayers." City/CUB Ex. 3.0 at 415-417. An enormous amount of revenues based on AMRP have been approved for recovery from PGL's ratepayers in the last two rate cases. City/CUB Ex. 3.0 at 117-119. Moreover, between 2014 and 2015, PGL expects the O&M amounts associated with AMRP to increase by 100%. City/CUB Ex. 3.1 (JA DRR to Staff ENG 3.03). Most of these costs will be recovered through PGL's Rider QIP. Given these clear cost consequences from AMRP, Mr. Cheaks testified that it is "vital that neither PGL nor CDOT waste the resources collected from the City's hardworking residents through utility bills or taxes." City/CUB Ex. 3.0 at 136-137.

The history of AMRP and the future painted in this record cannot give the Commission confidence that the new owners of PGL (who refuse to commit their resources to fund AMRP and who have no plan for AMRP post-reorganization) will manage AMRP such that PGL's ratepayers are not adversely impacted. Strong conditions are necessary to provide support for any such finding. It is undisputed that PGL includes amounts in the AMRP budgets and plans submitted to CDOT that are not consistent with their historical performance capabilities, anticipating that the work will not be completed in the permitted timeframe. City/CUB Ex. 3.1 (14-0225 PGL DRR to City 457 1.17(b)). In addition, PGL adds a 25-30% management reserve to AMRP project costs. CUB Ex. 3.1 (JA-City 4.10). Such a large reserve is out-of-line with Mr. Cheaks' 30+ years of construction experience, where he has seen management reserves of 6

or 7%. City/CUB Ex. 3.0 at 764-774. In fact, by PGL's own admission, the 25-30% reserve is above the highest end of the range within the industry. CUB Ex. 3.1 (JA DRR to Staff ENG 3.05, Attach 01). Mr. Cheaks concluded that while the large contingencies may reflect the reality of (and the utility's own expectations regarding) PGL's sub-par performance, extremely high contingencies may discourage accurate planning and budgeting. Ratepayers should not be paying extra to cover PGL's inefficiencies or to cover imprecision encouraged by unreasonably high reserves in poorly managed AMRP construction. City/CUB Ex. 3.0 at 764-774. Without conditions to ensure reduction in management reserves and to correct other costly inefficiencies, the Commission cannot find that PGL's ratepayers are protected from adverse impacts.

To protect PGL ratepayers from adverse rate impacts, the Commission must also address the lack of AMRP cost controls and incentives to reduce AMRP cost inefficiencies -- wasteful practices that the new management knows only second-hand and will have to confront. Mr. Cheaks described the results of the lack of management control and budgetary incentives, where, on multiple occasions, PGL has applied for permits that were not needed due to clerical error. In one instance, PGL's contractor paved with a concrete mix that was laid down on the Public Way when the temperatures were below standard, requiring a re-do of the whole job. Any work in a moratorium street requires payment of degradation fees. Since July 2012, PGL has paid the City $12,615,425 in degradation fees. City/CUB Ex. 3.6. On other occasions, PGL has submitted requests for permits for locations in which PGL had completed work in the recent past.

Such deficient record-keeping and communication, and the lack of coordinated planning within PGL will persist and could easily get worse if control passes to a reorganization with no transition or remediation plans. City/CUB Ex. 3.0 at 491-510. The Commission cannot speculate that a less experienced, plan-less, out-of-state corporation devoted to increasing its

shareholders' dividends will improve operations, when it rejects any obligation to improve anything. The ICC must exercise its authority to protect Chicago's ratepayers if it approves the reorganization.

PGL claimed that ratepayers are protected from waste or inefficiency in AMRP management because it requires at fault contractors to bear the costs of repairs for non-compliant work. However, Peoples Gas Contract Administration inspectors inspect only 3% of the repairs made by contractors to determine whether a restoration contractor is at fault for not adhering to Peoples Gas' specifications or CDOT regulations. CUB Ex. 3.1 (JA-City 4.08). In 2013, PGL found that contractors were at fault for **only 5%** of the notices of violation issued by the City. Absent other evidence, this means that PGL's ratepayers may bear the burden of paying the costs associated with the other **95%** of ordinance or permit violations. The Commission cannot support a finding of no adverse rate impact based on speculation that inspections of contractor performance required to capture errant contractor behavior will improve enough after reorganization (even though there are no substantive transition plans) to actually protect PGL's ratepayers from these inefficiencies and associated adverse rate impacts. City/CUB Ex. 3.0 at 573-578. According to PGL, its Change Order process, along with the competitive bid process, is what it relies upon to limit exposure to fees, penalties, or other amounts for non-compliance with applicable laws and regulations. CUB Ex. 3.1 (JA DRR to City 4.08). But the Change Order rate experienced in 2012 was approximately a 38% increase to the original award. City/CUB Ex. 3.0 at 474-478. And 2012 was not an aberration. Since 2011, PGL has submitted changes to their initially provided schedules for 2,606 projects. City/CUB Ex. 3.5. Despite PGL's claim that its ratepayers are protected from paying for defective work through warranties, that assertion cannot be verified, and is doubly dubious because PGL does not even track the

number or percentage of instances where restoration or repair work was found to be defective. CUB Ex. 3.1 (JA-4.08).

The Commission's chosen auditor of PGL's AMRP verified Mr. Cheaks' conclusions, not the Joint Applicants'. In particular, "[redacted]" Staff Ex. 8.0, Attachment A at 21. Indeed, "[redacted]" Staff Ex. 8.0, Attachment A at 20. At the hearing, Wisconsin Energy confirmed that they did not even examine whether AMRP had such [redacted]. Tr. 196:8-16 (Leverett). In addition to observations similar to Mr. Cheaks', the auditors' recommendation to address those concerns was also very similar to Mr. Cheaks' proposed solution. "[redacted]" Staff Ex. 8.0, Attachment A at 5.

The Commission must act to protect Chicago ratepayers from continuing or worsening mismanagement of AMRP, especially given that the proposed owners (1) have no plan for AMRP, (2) refuse to commit to substantive improvements in the program, (3) refuse to commit their resources to fund AMRP, and (4) have little to no experience operating in an environment like Chicago. The fact that existing line personnel, with their knowledge, experience, and relationships, may also change provides ample reason for the Commission to protect PGL's

ratepayer from the adverse rate impacts that are likely to occur absent adoption of the conditions recommended by Mr. Cheaks.

WEC's AMRP Commitments Fail to Protect Illinois Ratepayers from Adverse Rate Impacts

In order to bring these stark AMRP cost inefficiencies under control, WEC Energy Group has committed only to "carefully review" the results of the Commission's audit of AMRP. WEC states that it will ensure that Peoples Gas works to coordinate with the City of Chicago in the execution of the AMRP. JA Ex. 15.1 Rev. at 1. Given PGL's history of endless and ineffective coordination meetings, Mr. Cheaks concluded that this commitment was lacking in substance: "all WEC could offer was to review the current audit and "consider" adoption of recommendations concerning coordination with the City. In my opinion, this commitment is weak to begin with, and it is subject to conditions and caveats to the point of being meaningless." City/CUB Ex. 3.0 at 384-397.

PGL admits in its Monthly AMRP Reports that one of AMRP's "Major Risks" is its "Poor communications with City and elected officials impacting schedule." That level of performance in a stable organizational environment raises significant concerns about the direction of changes in coordination after the proposed reorganization. WEC's "commitment" merely to "consider" coordination related recommendations from an incomplete audit that may or may not address the concerns detailed by the City exacerbates the situation. City/CUB Ex. 3.0 at 398-408. PGL's perspective on whether the future portends more of the same or changes (and whether for better or worse) was denied the Commission by the Joint Applicants' decision not to provide PGL witnesses on this issue.

City/CUB's AMRP Conditions are Required to Protect Illinois Ratepayers from Adverse Rate Impacts

Without Commission action, the costs of mismanagement of AMRP, which may worsen as an inexperienced, unwilling, and unprepared owner takes control, are likely to result in adverse rate impacts for PGL's ratepayers. The record evidence establishes that significant portions of those costs are attributable to remedial work that could be eliminated by fixing PGL's management deficiencies. City/CUB Ex. 3.0 at 123-134. CDOT's incomplete efforts to establish more efficient cooperation with PGL are at greater risk in a reorganization. PGL's ratepayers (also tax-paying City residents and businesses) need the Commission to exercise its authority to protect their interests in avoiding adverse rate impacts, by assuring efficient, cost-effective management and performance in PGL's largest project ever. City/CUB Ex. 3.0 at 123-134.

In addition to imposing conditions designed to avoid the costs of non-compliant work, the Commission should require PGL to "take advantage of management efficiencies provided for in the CDOT regulations and through the PCO process." City/CUB Ex. 3.0 at 421-425. If PGL were to take advantage of those opportunities, it could work as scheduled and budgeted without having to ask that Chicago ratepayers pay even higher rates. City/CUB Ex. 3.0 at 421-425. If properly managed and communicated, these efficiencies should result in reduced paving and restoration costs for PGL's ratepayers as well as for the City's taxpayers. City/CUB Ex. 3.0 at 589-603.

The Joint Applicants point to Rider QIP proceedings as sufficient to protect ratepayers from adverse impacts. However, those proceedings will provide only a narrow opportunity for the intervenors to, once again, spend limited resources to challenge certain additions made at

certain dates. City/CUB Ex. 7.0 at 296-307. Those proceedings will not allow the Commission to review the AMRP program as a whole or its future (and future performance) in a proceeding where the Commission is charged with imposing conditions needed to protect ratepayer interests when the utility is involved in a reorganization. Although the Joint Applicants do point out various sources of information they will be required to provide regarding PGL's AMRP, none of those sources replicates the information requested by Mr. Cheaks. City/CUB Ex. 7.0 at 296-307. In fact, most are simply after-the-fact oversight reviews, not the timely information requested and needed for efficient construction management.

To ensure that PGL will be motivated to improve its AMRP performance such that its ratepayers are protected from adverse rate impacts, Mr. Cheaks proposed various performance metrics that incentivize and measure improvement, backed up by associated penalties for performance failures tied directly to the percentage increase in rates that PGL would enjoy in the year being examined. Mr. Schott claims that Mr. Cheaks' proposed metrics are unnecessary due to existing (failed) oversight and because the Joint Applicants have committed to report information about AMRP to Staff (after the fact, and possibly documenting sub-par performance). JA Ex. 9.0 Rev. at 149-155. The Joint Applicants were unable to existing mechanisms that produce the same operational information needed for performance that Mr. Cheaks' metrics propose to measure. Moreover, the existing mechanisms the Joint Applicants claim are adequate have clearly failed PGL ratepayers, given the undisputed dysfunction of AMRP at present.

The Commission should reject the Joint Applicants' argument and adopt Mr. Cheaks' recommendation to protect PGL's ratepayers through the imposition of penalties for failure to

improve mismanagement of AMRP. Even Mr. Schott concedes that such tracking is feasible and that an effectively managed AMRP would reduce customer rates. *See* JA Ex. 18.0 at 122-123; Tr. 95:5-11 (Schott). Mr. Giesler provided more specific criticism of each of Mr. Cheaks' proposed metrics and his criticisms will be addressed by individual metric:

Being on Schedule

Mr. Giesler claimed that AMRP is improving and that the threat of CDOT citations incents compliance. Mr. Giesler's claim is contradicted by the record evidence of AMRP performance. Permit timeframes are not improving; performance is actually declining. City/CUB Ex. 3.0 at 646-652. Fines and penalties do not appear to deter PGL from more violations or to incent better performance. City/CUB Ex. 3.0 at 552 (illustrating that fines assessed increased each year from 2011-2013). PGL is often required to pay for new permits when they fail to complete AMRP work in the permitted timeframe. The fact that PGL does not see a "business need" to track that performance to reduce permit fees *is the very problem Mr. Cheaks' proposals seek to address*. Moreover, PGL's failure to follow schedules affects every other entity's scheduling in the Public Way, reducing opportunities to save costs, and increases costs when paying contractors to be available, ordering supplies, or any other transactions contingent on construction schedules. City/CUB Ex. 7.0 at 310-323.

Being on Budget

Mr. Giesler claimed that the Commission currently has auditability and transparency into the performance of the AMRP program and can monitor and assess the prudence of spend. Mr. Giesler misses the point. Even if he is correct that the Commission has the power to assess these

metrics, PGL's poor performance has persisted regardless and thus illustrates that, without improving its own oversight and management (most effectively with shareholder dollars at stake), the Commission cannot be sure that performance will not worsen after reorganization. If this information is already tracked, there is no burden. City/CUB Ex. 7.0 at 324-329.

Better Design

In order to determine whether the AMRP design and construction process is taking advantage of efficiencies and avoiding waste, it is crucial to understand how Change Orders operate in the process and affect budget and schedule adherence. The Joint Applicants concede that Peoples Gas does not track cumulative dollar amounts of change orders. The Commission should require PGL to track and reduce Change Orders, with penalties for shareholders. Without such a condition, it may be impossible to know if PGL's planning and design process is realistic. City/CUB Ex. 7.0 at 330-342.

Management Reserve Spending

Without a commitment in this proceeding, the ICC cannot ensure that any improved Joint Applicants' system will be in place to improve PGL's management reserve practices. The Joint Applicants also do not address the unreasonable size of PGL's management reserve, and they provide no reason not to share this information on an ongoing basis with either the ICC or CDOT. City/CUB Ex. 7.0 at 343-353.

Time needed to close a Field Order Authorization and Change Orders

Despite receiving permits for three-times the normal timeframe, PGL is unable to control costs associated with changes to its designs. The Commission must act to put shareholder dollars at risk, otherwise PGL ratepayers bear the entire burden of paying for continued inefficient management. As explained above, implementation of this requirement need not be delayed. Without tracking this information, the ICC cannot assess the reasonableness of PGL's design process. City/CUB Ex. 7.0 at 354-363.

Contractor hits on all facilities

Mr. Giesler claimed that these hits are tracked and that associated costs are not recovered from ratepayers. JA Ex. 19.0 at 108-139. The Joint Applicants provide no information as to why that information should not be provided to the ICC and CDOT. Without improving performance on contractor hits, the ICC cannot be sure that PGL's AMRP will not adversely affect the interests of Illinois ratepayers, who are also Chicago property owners. City/CUB Ex. 7.0 at 364-369.

City/CUB has not proposed the recommended metrics and penalties lightly. CDOT has conducted detailed planning, permitting, meetings, coordination, and enforcement measures for all users of Public Ways, including PGL. City/CUB Ex. 3.0 at 956-966. Through these measures, CDOT has attempted, but failed, to successfully instill best practices and cooperative behavior in PGL's implementation of its AMRP. City/CUB Ex. 3.0 at 966-970. "Even in today's stable organizational structure, something more is required to spur improvement." City/CUB Ex. 3.0 at 956-076.

Mr. Cheaks testified that the necessary management improvement cannot be accomplished through some simple, one-time action. City/CUB Ex. 3.0 at 970-976. In order to protect the interests of PGL's ratepayers, Mr. Cheaks recommended that PGL should be annually required to show measurable improvement in each of the six categories -- at least at the same pace that rates rise for PGL's ratepayers. These amounts would not be large in the context of PGL's multi-million dollar expenditures for AMRP, but they would be known and tangible consequences for management inefficiencies that have persisted too long -- penalties borne by shareholders instead of PGL's ratepayers.

The Commission's chosen auditors also corroborate the need for measures like those recommended by Mr. Cheaks. In their Interim Audit Report, Liberty noted that the following would be necessary to implement in order to improve AMRP performance: [redacted] Staff Ex. 8.0, Attachment A at 8, 12, 14-16, 6-8, 16-21. Without the plainer and firmer commitments of the type recommended by Mr. Cheaks, there is no assurance that the deficiencies identified by Liberty will be addressed post-reorganization. Thus, Mr. Cheaks concluded that "[t]he Commission must establish conditions that are clear and specific, that incorporate metrics to evaluate compliance, and that define enforceable consequences for failure to meet the conditions." City/CUB Ex. 10.0 at 57-62.

2. Cost of Capital Inflation from Reorganization Debt and Capital Reduction from Dividend Payments

As discussed above in Section III.D. ("No impairment of ability to raise capital"), WEC Energy Group proposes to take on $1.5 billion of acquisition debt to fund the purchase of Integrys' common stock, and the cash to service that debt will come from its utility subsidiaries. City/CUB Ex. 4.0 at 13:309-314. Though the utilities currently have access to capital markets on reasonable terms, ratings downgrades are possible if not likely following the merger. *See* CUB Cross Ex. 3, JA MGM 1.15, Staff Ex. 7.0 at 9:183-185. City/CUB will not repeat the arguments set forth in Section III.D. here, but incorporate them herein by reference. Adverse rate impacts resulting from increased costs of capital for the utilities will occur in the event of a credit ratings downgrade for the utilities following the merger. Thus, the proposed reorganization fails to meet the 7-204(b)(7) criterion.

3. Transition Cost Recovery

The protocols for ratemaking treatment of the costs of integrating the Joint Applicant firms into a single reorganized entity -- which the Joint Applicants call "transition costs" -- are an essential, but poorly defined process that cannot support the required Commission finding that adverse rate impacts are not likely. 220 ILCS 5/7-204(b)(7). In fact, development of a cogent process was an after-thought, wholly neglected until the Joint Applicants were prodded by advocates for affected ratepayers. Tr. 408 (Reed). Still, details of the process are few and hastily cobbled together; basic cost identification, tracking, and accounting processes are lacking; and the Joint Applicants leave tens of millions in potential rate increases subject to *ad hoc* processes to be defined during a future rate case. Tr. 403 (Reed).

However, the required Commission finding must be made in this case, and the Joint Applicants' proposal, commitments, and evidence do not provide adequate support for that

finding. On examination of the record, it is apparent that the Joint Applicants' preparations are not adequate to assure that post-reorganization rates will not improperly recover costs prohibited by Section 2-704, or by the Joint Applicants' own commitments.

a. Background

The Joint Applicants distinguish two types of reorganization costs. The first category of costs comprises fees and expenses incurred to complete the paper transaction that will formally transfer ownership of the shares in Integrys to another entity controlled by WEC. City Group Cross Ex. 1, JA-City DRR 6.08. Under the reorganization proposal -- and consistent with past Commission treatment of such "transaction costs" -- these costs will not be recovered through rates from regulated utility ratepayers. JA Ex. 15.1 Rev., Commitments 16, 17 and 20. The Joint Applicants have made this a formal part of their reorganization proposal through commitments that are to be made part of the order approving the reorganization, if it is approved. JA Ex. 15.1 Rev., Commitment 16 and n. 2.

The costs associated with the transformation of formerly separate organizations into a new integrated corporate organization make up the second category of costs. The Joint Applicants call these costs "transition costs." City Group Cross Ex. 1, JA-City DRR 6.08. Under the proposed reorganization, as clarified by the Joint Applicants' commitments, the Joint Applicants expect to receive rate recovery of some (perhaps most) transition costs. Tr. 384-385 (Reed). To help their proposal meet the Section 7-204(7) requirement that adverse rate impacts for utility customers must be unlikely, the Joint Applicants augmented the proposal with two transition cost-focused Commitments. According to those Commitments, transition costs will be identified, tracked, and accounted for in a manner that assures the Commission that transition costs are recovered only to the extent of the associated "net savings."

> Commitment 17. The Gas Companies shall separately track identify and track transaction costs and transition costs.
>
> Commitment 21. Transition costs may be recoverable to the extent the transition costs produce savings. JA Ex. 15.1 Rev.

"Net savings" represent a calculation of savings minus costs,[6] for the relevant asset or initiative and time period. This is the concept that the Joint Applicants propose to use in determining which costs may properly be recovered from utility ratepayers. *Id.*, Commitment 21; Tr. 369 (Reed). An acknowledged, necessary consequence of that approach is that costs incurred for purposes other than the achievement of net savings are ineligible for recovery from utility ratepayers. Tr. 371 (Reed). Thus, where initiatives (and implementation costs) are necessitated by the reorganization but are implemented for reasons other than to achieve savings -- e.g., moving all companies to a common accounting system, or relocating organizational elements for management cohesion -- such costs will be separately identified and excluded from the amounts eligible for possible rate recovery. In addition, the utilities expect that some transition costs of affiliated companies will be allocated to the utilities. Such allocated transition costs will be subject to the same tracking protocols, eligibility criteria, and ratemaking proofs as a utility's own transition costs. Tr. 372-373 (Reed).

b. The Joint Applicants' Proposed Ratemaking Treatment

The Joint Applicants' proposal presents problematic identification, tracking, and rate recovery issues related to costs for the post-closing process of melding separate corporate entities into an integrated organization. These issues relate directly to the rate impacts of the proposed reorganization. Many of the problematic issues are direct results of the Joint Applicants'

[6] Open issues such as whether to use achieved or expected savings, the appropriate evaluation period, when recovery is allowed, and unrealized expected savings add complications that will be discussed later in this brief.

strategic decision to delay planning and preparation for that assimilation process. *See Joint Applicants-Commissioners DRR No. 1*. The Joint Applicants' decision not to develop transition plans and estimates of costs or savings avoids any up-front allocation of estimated savings and risk to the Joint Applicants, but that decision necessitates far more complex and uncertain ratemaking mechanics. The most important consequence is the need to have in place -- from the beginning of the transition (the closing) -- rigorous protocols for accurate identification, classification, and calculation of costs eligible for rate recovery,[7] to assure that adverse rate impacts on retail customers are not likely.

However, the Joint Applicants' ill-defined proposals do not assure the result required by the statute. Because of the structure of the proposal in this case, if the record is inadequate on any one of several points, the statutory requirement for a Commission finding that adverse rate impacts are "unlikely" cannot be met, and the reorganization cannot be approved. Whether intended or not, the Joint Applicants' tactical delay in serious implementation planning has the effect of making all transition costs potentially recoverable through utility rates. Thus, to satisfy the threshold rate impact criterion for reorganization approval, the Joint Applicants' evidence must assure the Commission of (a) the improbability of reorganization related cost recovery that has an adverse impact on utility customers, (b) the certainty of compliance with transition cost Commitments incorporated in a reorganization approval order, and (c) the Commission's ability to accurately identify and quantify recoverable transition costs for lawful ratemaking, even in the absence of Commission-reviewed protocols for identifying and tracking transition costs and any associated savings.

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[7] Under the PUA, reorganization costs deemed "eligible" for rate recovery must still satisfy applicable ratemaking criteria (like reasonableness and prudence).

The task of identifying, tracking, and properly classifying (for rate recovery eligibility) varieties of transition costs is neither simple nor routine for the utilities that must complete it. And at this point, the utilities are not involved in the just-begun operational development of those procedures. Tr. 408. (Reed: Reed and Lauber had two phone calls "right after we received 13.05")). Transition costs may serve multiple functions and may be recorded, on a case-by-case basis, in various accounts, or separately from established accounts. Tr. 375. (Reed). Transition costs may be incurred over a period of years, with an objective of achieving savings only in the long term. Still undefined accounting and recovery protocols must identify certain (also undefined) transition costs that may become ineligible for rate recovery only if they exceed a baseline, pre-reorganization level, and treat them differently, to exclude the "but for reorganization costs."[8] Tr. 371 (Reed). Associated "net savings" for each set of transition costs require similar identification, tracking, and accounting to determine the recovery cap, whether costs are tracked by initiative, asset, function, or other criteria. Each of these variations presents its own complexities and conundrums.

In addition, adding another layer of complexity, in any of the above circumstances anticipated net savings may not be realized. Where reliance on projected but un-achieved savings results in premature (and improper) recovery, meaningful enforcement of the commitment to cap transition costs at net savings would require an adjustment to past rate

[8] The use of such total company benchmarks to track transition costs and savings is problematic under the Commission's interpretation of Section 7-204(b)(7). "Patently, the legislature intended that the Commission, through 7-204(b)(7), would only identify characteristics of the proposed merger that were likely to adversely impact rates in subsequent rate proceedings, and to withhold or condition merger approval - not establish rates - when such characteristics were present." *Nicor Merger* at 30. Moreover, the Joint Applicants have not addressed such a benchmark process in this record, much less shown it to be acceptable for ill-defined costs in a reorganization inquiry.

recovery. There is no such mechanism in current ratemaking processes, and the Joint Applicants have not presented one here.

The expected magnitude of the Joint Applicants' transition costs is significant. The Joint Applicants' reorganization expert, Mr. Reed, estimated that they could amount to "tens of millions" of dollars. Tr. 369 (Reed). Timely establishment of rigorous accounting and classification protocols for such large amounts -- which the utilities plan to include in rates -- is essential to avoid severe, adverse impacts on utility customer rates, as well as misallocations of costs and possible cross-subsidization of non-utility activities. *See* Section 7-204(b)(2), (3), and (7).

Consider the following reasonably anticipated ratemaking scenarios, for which the Commission must find that adverse rate impacts are unlikely, as a pre-condition to reorganization approval. 220 ILCS 5/7-204(b)(7).

• Scenario A. Assume that a reorganization transition project is in progress. In a rate case during that period, the utility reports that the initiative's net savings to date are exceeded by the initiative's incurred transition costs, yielding negative net savings. Tr. 376 (Reed) (net savings can be negative). The Joint Applicants have not defined a calculation that could determine the amount of transition costs (if any) recoverable in test year rates, consistent with their proposed commitments. Whether the calculation is further complicated by consideration of test year transition costs and test year net savings is not clear from either the Commitment language or the Joint Applicants' explanatory testimony. Tr. 405-407 (Reed) (consideration of test year data contemplated). In fact, whether involving test year results is more likely or less likely to result in adverse rate impacts cannot be determined from this record. And with no record description of effective protocols, there is no basis for a finding that, in future rate cases,

ad hoc transition cost recovery determinations will be sufficiently accurate and Section 7-204(b)(7) is satisfied with certainty.

• Scenario B. In the situation described above, assume further that the utility reports that though costs currently exceed savings, it expects to achieve positive net savings over the life of the initiative. An initiative's costs and savings can each exceed the other at one or more points during the initiative. *See* City Group Cross Ex. 1, JA-City 13.05 (illustrating cost/savings patterns). Because Commitment 21 caps cost recovery (that is, the utility "may" recover costs up to the cap), the only way to be certain of compliance is to calculate recoverable transition costs using achieved net savings. However, the Joint Applicants have indicated clearly (though inconsistently) that they contemplate the use of projected net savings to determine recoverable amounts for ratemaking. Tr. 380 (Reed)

The Joint Applicants suggest that the Commission's decision to rely on projected amounts to set rates in a recent formula rate proceeding provides a solution to the problems created by its transition costs proposal. Tr. 381-382 (Reed) (referring to the amortization of merger costs in *Re Commonwealth Edison Company*, ICC Docket No. 13-0318 ("*ComEd Reconciliation")*, Final Order of December 18, 2013 at 22). They are wrong. The relevant circumstances of that proceeding and the Commission's decision are inapposite.

First, the case was a reconciliation proceeding in a statutory electric utility formula rate regime that has no application to any of the Joint Applicants. *See* 220 ILCS 5/16-101. The very presence of statutory reconciliations in that regime distinguishes the irreversible cost recovery process that must be assessed in this case. (Indeed, in the ComEd case, the issue arose because a ratemaking error needed correction. *ComEd Reconciliation* at 22.) The unique definition of recoverable costs in that process (actual costs) is intended to protect against improper cost

recovery and does what the use of achieved savings (opposed by the Joint Applicants) would do for the cost recovery at issue in this case. Contrasting the difficulties of tracking costs and savings being realized at different speeds, annual formula rate reconciliations provide frequent opportunities to review and to correct ratemaking errors. Here, however, there is no assurance of even one chance to review the continued propriety of amortized costs based on projected savings, and no opportunity to reverse an over-recovery.

Second, the test for acceptable formula rate determinations is not the same as the statutory test of Section 7-204. In the prior ComEd proceeding, the Commission had approved the cost recovery being corrected (in the following reconciliation) because savings were then deemed "reasonably likely to occur," which is not the same as the statutory requirement that adverse rate impacts are "not likely."[9] (In fact, in that case actual savings varied from the projections.) *Re Commonwealth Edison Company*, ICC Docket No. 12-0321, Final Order of December 19, 2013 at 79. The stricter standard of Section 7-204 requires that the Commission find affirmatively that under reorganization approval -- and the proposed ratemaking treatment of reorganization-related costs -- adverse rate impacts are unlikely. Given the absence of annual reconciliations, costs not limited by actual occurrence, and the irreversibility of rate determinations for the reorganized utilities, the likelihood of adverse rate impacts is considerable. A variance from projected savings after having billed customers based on those projections cannot reasonably be found unlikely on the evidence in this record.

The Joint Applicants also suggest that the necessity of Commission approval in ratemaking proceedings virtually guarantees that adverse rate impacts are not likely. JA Ex. 8.0

[9] Despite their reliance on this decision (Tr. 381-382), the Joint Applicants have provided no case law equating the two standards.

(Reed) at 8:152. That is not correct. If the burden of identifying and challenging improper reorganization costs buried in various tracking schemes is shifted to ratepayer advocates in future rate cases, the Commission cannot reasonably find that adverse rate impacts are unlikely. As City/CUB expert Mr. Gorman explained:

> The burden of proving whether or not the transition costs incurred were prudent and reasonable and produce verifiable savings should not fall on other parties to the rate case. In the absence of suitable proof, any imprudent, unreasonable or unproven transition costs and any costs of achieving unproven savings, should be the responsibility of the Joint Applicants or the utility, not ratepayers.

City/CUB Ex. 8.0 5:99. Moreover, the complexities of determining properly recovered costs when costs and savings do not advance in lock step may be practically insurmountable. A process that depends on under-funded ratepayer advocates or Commission Staff finding and correcting improper recovery is not one for which improper recovery (and adverse rate impacts) are not likely.

The weight the Commission gives the Joint Applicants' transition cost recovery proposal should match the meager attention the Joint Applicants gave this vital ratepayer protection. The record shows that until the week before evidentiary hearings, when pressed by discovery from City/CUB, the Joint Applicants had not tried to develop a detailed process that could accommodate their approach to transition costs and meet the rate impact requirement of Section 7-204(b)(7). Tr. 408 (Reed). Unsurprisingly, the Joint Applicants' testimony confirms that the processes the Joint Applicants offer to supplant routine rate case ratemaking are not well-defined; nor is it likely to be effective. The Joint Applicants own testimony calls into serious question the value of the Joint Applicants' proposed Commitment 17 regarding transition costs.

The Commission should reasonably expect that the Joint Applicants would (at the very least) be able to explain the framework of the process they claim can assure proper rate treatment of transition and transaction costs, thereby preventing adverse rates impacts. Yet, scenarios like those described above elicited only uncertain possibilities, not answers, from the Joint Applicants' experts. City Group Cross Ex. 1, JA-City 13.05. Despite the uncertainty about the efficacy of their undefined protocols, the Joint Applicant witnesses rejected City/CUB proposals for firmer, more detailed commitments as a way to reduce the likelihood of adverse rate impacts. Such evidence cannot support a finding that adverse rate impacts are unlikely.

Lacking any showing of a process for the identification, tracking, accounting, and ratemaking treatment of reorganization transition costs (and savings), Commission approval would be unlawfully based on pure speculation -- that the Joint Applicants will be able to devise and timely implement a system that solves the described problems so completely that adverse rates impacts become unlikely. In fact, it is at least as likely that in the absence of rigorous tracking -- in place from the beginning -- such problems will not even be uncovered, much less resolved without adverse rate impacts. The Joint Applicants' proposal to wait until future rate cases to present evidence needed in this case and to define how transition cost recovery will be defined in the context of rate case test years makes adverse rate impacts even more likely.

In City/CUB's view, the Joint Applicants have not developed or presented cost identification and ratemaking protocols adequate to support that threshold Section 7-204(b)(7) finding. The absence of a rigorous, effective cost/savings tracking process and the sheer complexity of managing ratemaking treatment of tens of millions in ill-defined transition costs and "net savings" make adverse impacts likely.

4. Length of Rate Freeze

The Joint Applicants' heavily-conditioned commitment that they will not request a base rate increase that would take effect sooner than two years after the close of the reorganization does not ensure that the reorganization will not have adverse rate impacts, or that customers will receive the benefits the Joint Applicants claim their reorganization proposal will provide. As worded, the Joint Applicants' Commitment 1 merely delays the Joint Applicants' next rate case filing for about one year but leaves in place rate changes due to "[a]ll riders and automatic adjustment clauses in effect." JA Ex. 15.1 Rev. at 1. Given the utilities' current rate structures, the significant value to shareholders of the various riders on which the Joint Applicants' commitment is conditioned, and the potential for available synergy savings from the reorganization (though the Joint Applicants have declined to quantify those savings), extending that time period to five years, as proposed by City/CUB witness Mr. Gorman, is more appropriate. City/CUB Ex. 4.0 at 10:245-247.

Over 70% of PGL's capital investment expenditures are subject to recovery (with a return) through Rider QIP, and other revenue stabilizing mechanisms ensure recovery of other revenues. City/CUB Ex. 4.0 at 8:194-195, City/CUB Ex. 8.0 at 3:57-61. In fact, for PGL, the rate base used to set base-rates will have little or no increase over the next five years, because the amount of capital expenditures to be recovered through base rates is approximately equal to the amount of annual depreciation expense recovered by the utilities each year in utility non-fuel revenue receipts. City/CUB Ex. 8.0 at 4:64-69. Though North Shore does not have a rider like Rider QIP in effect currently, it has other mechanisms that, coupled with the savings that it should enjoy as a result of the reorganization, make a five year rate freeze reasonable for North Shore as well. *Id*. at 4:72-78.

While the utilities' new shareholders will enjoy the revenue assurance provided by capital improvement riders, bad debt riders, decoupling riders, fuel cost recovery riders, and riders regarding manufacturing gas plant cleanup, ratepayers are burdened by the same revenue assurances. City/CUB Ex. 4.0 at 8:184-189. A five-year rate freeze would help create similar assurance of benefits for customers, in the form of increased rate stability and mitigated base rate increases over the period of the freeze. *Id*. at 10:228-232.

A five-year freeze will incent the Companies to maximize the amount of savings that can be generated as a result of the reorganization. *Id*. at 4:78-80. For example, the Joint Applicants plan to consolidate service company operations, producing some synergies from the creation of this larger company. City/CUB Ex. 4.0 at 9:207-208. However, as described more fully in Section III.F.4 (Transition Cost Recovery), the Joint Applicants have declined to do transition planning to capture available savings, to acknowledge near-term potential savings, or to quantify potential savings that could be produced by the reorganization. Adverse rate impacts could result from the Joint Applicants' disincentive to obtain cost-saving synergies prior the time at which the freeze period ends. A longer period would encourage the Joint Applicants to capture more of those available savings, which should offset any claimed revenue deficiencies.

The Joint Applicants claim that CDOT regulations have led to cost increases that will require a base rate case sooner than five years after the merger close. However, both practically in their construction management and in their evaluation of freeze effects, the Joint Applicants have ignored the savings opportunities included in new CDOT regulations. City/CUB Ex. 8.0 at 4:81-83. The Joint Applicants have failed to quantify, or even acknowledge, those opportunities. *Id*. at 4:83-84. Savings achieved by PGL and NS during a freeze will accrue to the utilities' shareholders, until rates are revised in the first post-reorganization base rate case. The onus

should be on those companies to maximize savings opportunities, and a longer rate freeze creates greater incentives for the companies to do so. As discussed in the Transition Costs section (section III.F.4) of this Initial Brief, the Joint Applicants have proposed a different approach.

Whatever the period of the freeze, as proposed by the Joint Applicants, their Commitment is heavily conditioned. In addition to being contingent on all the utilities' existing riders and automatic adjustment clauses remaining in effect (including Rider QIP), the Joint Applicants request an early exit option that would give PGL and NS the right to request a waiver from the rate freeze based upon a perceived threat to the financial integrity of a utility. City/CUB Ex. 4.0 at 7:169-175. While a financial waiver provision is not necessarily unreasonable in the event of a five-year freeze, in the case of a two-year period, the provision would only delay a rate filing for a period of months or even less, and does not justify an option for early termination of the Commitment.

The problematic treatment of transition costs proposed by the Joint Applicants and a short freeze period would encourage the Joint Applicants to put off any integration plans that could benefit customers until the freeze period ends. At the end of the freeze, the cost recovery risks associated with expenditures for integration planning and execution (to achieve reorganization savings) is transferred from shareholders to ratepayers through the proposed scheme for transition cost recovery in rate cases. Ratepayers would pay for implementing the management/shareholder reorganization decision, and shareholders would be insulated from the possibility of large losses from failed synergy expectations or a poor reorganization gambit. Tellingly, under the Joint Applicants' proposed time lines, the transition is projected to begin, costs are expected to be incurred, and transition costs will be eligible for rate recovery at about the same time that the proposed freeze would end. *See* JA Ex. 9.0 (Schott) at 25:534.

If an early termination option is retained in the proposed Commitment, the burden of proving financial need for increasing base rates should be clearly placed on the utility at the time of that filing. *Id*. at 10:233-239. A waiver should be granted only if necessary (not just desirable), such as to maintain an investment grade bond rating outlook. *Id*. at 10:240-242. The standard should be set high for any waiver, and a mere expectation that earnings may be reduced should not be an acceptable reason to waive adherence to a Commission-ordered rate freeze. *Id*. at 10:242-244.

G. Section 7-204(f) -- terms and conditions necessary to protect utility and customer interests

1. The Joint Applicants' Minimization of Record Evidence Requires Commission-Imposed Conditions to Address Risks Created by the Missing Information

The Joint Applicants' strategic decision to minimize the information provided to the Commission in this proceeding purposefully frustrates the clear and express legislative policy favoring comprehensive utility oversight. Particularly, regarding reorganizations, the General Assembly has indicated (by the quick response to a successful effort to evade Section 7-204's predecessor statute) its intent that the Commission's regulation be comprehensive and meaningful. However, the Joint Applicants' approach has unavoidable (and possibly unintended) side effects. The lack of record evidence makes it impossible for the Commission to make findings needed to satisfy the statutory criteria. (See the discussion of burden of proof above) Regarding Section 7-2024(f), the sparse record makes it difficult for the Commission to make informed decisions identifying and defining terms and conditions necessary to protect Illinois utilities and ratepayers. *See* Tr. 127 (apparent deliberate absence of utility testimony regarding utility infrastructure program).

As the Commission has held, because of the manner in which Section 7-204 is structured, a lack of evidence must redound to the Joint Applicants' detriment. *Nicor Merger* at 45. If the Commission lets a deliberately skimpy record distort the statutory standards, it encourages repetition of that strategy and will diminish the quality of the records on which its decisions must be sustained. The Commission must make the required findings, at the statutory level of certainty -- not at a lower level based on purposeful reductions in the quality and quantum of evidence. The Commission is required to protect the interests of Illinois utilities and their customers. Missing information provides no assurance of the mandated protection, quite the opposite. Unsupported assurances require the imposition of conditions to fill the gap with protective conditions, if the reorganization is approved.

2. City/CUB Have Identified Specific Modifications or Conditions Necessary to Protect the Interests of the Illinois Utilities and Customers

Recognizing that the inadequacies of its base reorganization proposal would not permit the required statutory findings by the Commission, the Joint Applicants added supplemental Commitments in an (unsuccessful) attempt to bridge the gap between the reorganization proposal's impacts and the statutory requirements that protect Illinois' utilities and their customers. In any case, the Joint Applicants' proposed Commitments are so heavily conditioned and lacking in specifics that they are of dubious value -- to the utilities' ratepayers, the Commission, or the state of Illinois. Moreover, the Joint Applicants have proposed no meaningful compliance measurement or enforcement provisions for the Commitments -- a critical deficiency that significantly reduces the level of assurance the Commission can draw from the Joint Applicants' promises. *See* JA Ex. 15.1 Rev.

While some of the Joint Applicants' commitments are laudable, the reorganization proposal, even as augmented by the Joint Applicants' Commitments, does not support the findings required for Commission approval. The proposal and Commitments can meet the statute's requirements only if they are modified and augmented as proposed in testimony and briefs by City/CUB. The modifications must include provisions that make compliance performance both measurable and enforceable. Several important areas where the Joint Applicants have made inadequate Commitments are discussed in greater detail below.

a. AMRP

Protection of the interests of PGL's ratepayers requires an examination of the status and future of the AMRP to inform the Commission of the need for and content of conditions imposed on any reorganization approval, respecting the operation and management of AMRP. The limitations on permitted uses of the Commission auditor's report on those issues curtail the Commission's ability to perform those tasks. However, that lack of record evidence means record-based concerns have not been allayed and impels more protective conditions, not fewer. The Commission has concluded that Section 7-204 imposes a "public interest test" on applicants. *Nicor Merger* at 38. In *Nicor Merger*, the Commission stated that its power under Section 7-101 to safeguard the public interest is a "broad power." *Id*. at 44. The Commission also noted that "[t]here is substantial overlap of [the interests protected by subsection 7-204(f)] and the public interest safeguarded by Section 7-101." *Id*. at 44, n. 240. The Commission's power to protect or safeguard the public includes the authority over activities conducted by entities the Commission regulates, to the extent necessary to carry out the ICC's duties such as prohibiting misleading marketing. *Id*. at 57, 66.

That broad power includes the authority for the Commission to reject proposed transactions to the extent they authorize a utility to engage in unknown arrangements that could negatively affect the public interest. *Ill. American Water Co.*, Docket. No. 02-0517, Final Order of September 16, 2003 at 11. Products or services that are not "properly priced" or "legitimately necessary" are not in the public interest. *Id*. at 16. The Commission must make findings appropriate to customers *in toto*. *Nicor Merger* at 64. Evidence pertaining to affiliates and their products and services are material to a Commission determination regarding the public interest insofar as it demonstrates effects on the utility. *Id.* at 70. Applying the public interest standard, the Commission has required a utility to cease using personnel and assets to engage in conduct that is inimical to the public interest. *Id.* at 72. The Commission has imposed conditions on applicants requiring them to pay the costs of auditing, including the costs of appearing before the Commission in other proceedings the Commission concluded were necessary to protect due process rights of intervenors. *In re Ill. Bell Telephone Co.*, ICC Docket No. 00-0260, Final Order on Reopening of September 12, 2011 at 9.

Here, WEC does not believe that there should be a "fundamental rethinking of AMRP oversight, management, and control" in order for the Commission to be sure that the interests of Illinois ratepayers will be protected subsequent to any approved reorganization. JA Ex. 12.0 at 115-124. However, the City's witness, CDOT Deputy Director William Cheaks, concluded that "given the long-term nature of the AMRP and its importance to the safety and reliability of gas utility service in Chicago, the Commission's determination of conditions required to protect the interests of PGL and its customers cannot be done without asking more than whether service will be worse after the stock transaction." City/CUB Ex. 7.0 at 138-142.

AMRP imposes many burdens on the City's residents, the overwhelming majority of whom are also PGL ratepayers. Even if PGL's program were managed well, it would still impose burdens on residents in the form of loss of Public Way use, increased traffic, greater noise, dust and debris, and other inconveniences that accompany heavy construction. When managed improperly, the effects are even worse. City/CUB Ex. 3.0 Appendix A contains photographs taken by CDOT inspectors that depict the burdens that PGL's construction activities impose on City residents. PGL's operation of AMRP is symptomatic of management deficiencies that can have real negative consequences on the infrastructure subject to the Commission's jurisdiction (pipes, mains, laterals, etc.). City/CUB Ex. 3.0 at 658-670. For instance, though permits to open the Public Way last 14 to 30 days, as an accommodation, CDOT has issued 90 day permits to PGL, multiplying the negative effects that each permit issuance may have on PGL ratepayers; those effects were exacerbated by PGL work outside permit time periods. City/CUB Ex. 3.0 at 642-644, 461-465.

Poorly managed AMRP activities also impose burdens on ratepayers -- in the form of added costs incurred due to a lack of coordination with CDOT and other utilities in rights of way. For example, Mr. Cheaks testified that, on "multiple occasions," PGL or its contractors have performed work in the Public Way without permits. City/CUB Ex. 3.0 at 461-465. In one such instance, without permission PGL had blocked access to the northbound lanes of Racine Avenue north of Madison Street. *Id*. Such activity inconveniences City residents and frustrates CDOT efforts to coordinate the construction projects in the Public Way and reduce the costs that, ultimately, Chicago ratepayers bear alone. City/CUB Ex. 3.0 at 461-465.

PGL's poor management also imposes costs directly on City ratepayers when PGL or its contractors damage property not owned by PGL; there have been at least 139 such incidents

since 2011. City/CUB Ex. 3.8. At least 95% of those involved gassed mains. *Id*. Over that same time period, PGL or its contractors have paid $1,026,270 to claimants, including several cases where claimant sustained 2nd degree burns or claimed more serious injury, plus at least six major case with damage claims in excess of $5 million. City/CUB Ex. 3.9. These effects, which the Joint Applicants refuse any commitment to improve, are diametrically opposed to the interests of PGL's ratepayers.

Even when managed properly, PGL's construction unavoidably burdens City residents and businesses, who are also PGL ratepayers. City/CUB Ex. 3.0 at 687-693. When managed improperly, the activities impose even greater burdens, such as lost business caused by improper opening or restoration of the Public Way. City/CUB Ex. 3.0 at 687-693. AMRP also impacts other infrastructure activities scheduled by the City's departments. CDOT's large street resurfacing program is negatively impacted by PGL's performance, where improper scheduling or communication often leads to costly waste, costs sometimes shifted to the City or taxpayers. City/CUB Ex. 3.0 at 696-699. When PGL occupies the Public Way for longer than it had scheduled, it can also limit the ability of emergency responders to use the Public Way to provide critical services to the City's residents and businesses. City/CUB Ex. 3.0 at 712-722.

Despite the management and performance issues identified by Mr. Cheaks, CDOT acknowledges that "things go wrong in the field," and attempts to accommodate changing conditions and plans. However, CDOT requires timely communication of what is changing and what is not in the field. City/CUB Ex. 3.0 at 810-816. Because the Joint Applicants have refused to commit to provide specific construction coordination and management information CDOT requires, the protection of PGL ratepayer interests requires conditions that force PGL to provide timely and substantive updates to CDOT.

WEC's AMRP Commitments Fail to Protect the Interests of PGL's Ratepayers

In their initial application and accompanying direct testimony, the Joint Applicants never mentioned the 2012 audit performed of PGL's pipe replacement program. City/CUB Ex. 3.0 at 93-94. That audit, performed by PwC, a consulting firm, recommended improvements to PGL's management and operation of AMRP. City/CUB Ex. 3.1 (JA DRR to Staff ENG 3.05, Attach 01). From browsing the lengthy audit report, it appeared to Mr. Cheaks that PGL understood at least some of the problems with their pipe replacement program, and the Company appeared to comprehend the audit's recommendations to integrate risk management processes, cost control procedures, project management scheduling, and the development of robust metrics with detailed requirements. City/CUB Ex. 3.0 at 97-102. Nevertheless, PGL did not implement these measures, if at all, until August of 2014 – just a few months ago. City/CUB Ex. 3.0 at 102-103. Promises by the Joint Applicants to implement the Liberty audit should be scrutinized by the Commission with this tainted history in mind.

WEC Energy Group has proposed a commitment to review the results of the Commission's current Liberty audit of the Peoples Gas AMRP and to ensure that Peoples Gas works to coordinate with the City of Chicago in the execution of the AMRP. JA Ex. 15.1 Rev., Commitment 7. However, the commitment is not firm, and it does not actually require implementation of the Commission auditor's recommendations. With respect to each recommendation contained in the report, the Joint Applicants have only committed to "evaluate the recommendation and implement it if [PGL determines that] the recommendation is possible to implement, practical and reasonable from the standpoint of stakeholders and Peoples Gas customers, and cost-effective." JA Ex. 15.1 Rev. at 1. Any disputes between PGL and Staff in

this process are to be resolved a potentially lengthy process that may culminate in a petition to the Commission. JA Ex. 15.1 Rev. at 1. "[T]hese commitments are still too heavily caveated to be significant." PGL determines what is "practical" "reasonable" and "cost-effective," subject only to resolution of disputes (for Staff alone) through a process guaranteeing only more lawyers' fees passed along to Chicago's ratepayers, and on PGL's timeline. City/CUB Ex. 7.0 at 198-205; Tr. 152:14-16 (Leverett). If the Commission approves the reorganization without a firm commitment to make the recommended improvements, as a condition or approval (and the Commission should not), CDOT (the most directly affected ratepayer) should be involved in any litigation of the Audit's recommendations regarding PGL's long-standing coordination and planning problems. City/CUB Ex. 7.0 at 198-205. These are not issues to be worked out between the Joint Applicants and Staff.

Given PGL's history of promise, non-performance, and failed attempts to correct deficiencies, less than absolute commitments are meaningless to PGL's ratepayers. CDOT has tried meetings, on a continuing basis, with the local management the Joint Applicants insist will mostly remain in charge of AMRP (although that may be change as three new WEC managers visit Chicago), but that process (embodied in the commitment) has resulted in the poor performance documented in Mr. Cheaks' testimony. City/CUB Ex. 7.0 at 212-218. Regarding the Liberty Audit Report's recommendations to establish a Chicago-based project management organization with personnel who are active in the field, Mr. Hesselbach dismissed those concerns as "implementation issues to be worked out with Liberty and Staff." JA Ex. 13.0 at 89-100. Mr. Hesselbach asserts that, because Wisconsin Energy uses a software tool referenced in the Liberty Interim Audit Report, that it will be ready, willing and able to implement Liberty's final recommendation to improve performance in scheduling and coordination. JA Ex. 13.0 at 132-

142. On these important points of the transition to WEC management, the Joint Applicants chose not to present testimony from the perspective of Peoples Gas or Integrys to confirm or deny the readiness, willingness, and ability of Wisconsin Energy to implement Liberty's recommendations, despite Mr. Schott's admission that those entities would be better positioned to make that determination. Tr. 89: 6-10.

To their credit, the Joint Applicants have committed to two necessary fixes to improve the future of AMRP construction by agreeing to "open a new state-of-the-art training facility for the Gas Utilities in the City of Chicago" and an extension of the veterans' worker training program located at the City Colleges of Chicago's Kennedy King College's Dawson Technical Institute. JA Ex. 6.0 at 157-160, 154-155. Both these programs will support proper modernization of Chicago's gas utility infrastructure, by assuring the availability of properly trained skilled workers for the decades-long AMRP undertaking. (As discussed under section 7-204(f), City/CUB note that the Joint Applicants oppose modifying their employee commitment (Commitment 2) to assure the proper mix of skilled employees.) City/CUB Ex. 7.0 at 166-178. However, these commitments alone are insufficient to protect PGL's ratepayers' AMRP interests, since they fail to prove, by a preponderance of the evidence, that management and operation of AMRP will not worsen PGL's service abilities. 220 ILCS 5/7-204(B)(1) and (f).

City/CUB's AMRP Conditions are Required to Protect the Interests of PGL's Ratepayers

Mr. Cheaks testified about CDOT's regulations governing opening of and construction in the Public Way, the extensive CDOT accommodations for PGL's AMRP, and the results of those efforts. CDOT's regulations are meant to protect the Public Way from the various uses and abuses and are the principal means of efficiently coordinating work in, on, or under City streets

while minimizing disruption of public use, unnecessarily repeated street cuts, and wasteful construction expenditures by the City and other users of Public Ways. City/CUB Ex. 3.0 at 156-161. To coordinate activities in the Public Way and help regulated entities comply with the City's requirements, the PCO was opened as a joint City-User coordination office in April of 2012. The PCO facilitates communication and collaboration and directs entities to coordinate the scheduling of all work within the Public Way, for planning as well as daily operations. Along with CDOT, providers of transportation, utility and communications services to the City, and the City's Department of Cultural Affairs and Special Events, are stakeholders in the PCO. City/CUB Ex. 3.0 at 172-189.The PCO reviews five-year Capital Improvement Projects; distributes scheduling and restoration conflicts and/or opportunities with stakeholders; maintains the integrity of the OUC database; hosts weekly coordination meetings ("Focus Group Meeting"); develops Memorandums of Understanding ("MOU") for restoration sharing amongst stakeholders; and offers a single site location with a calendar of conflicts among other duties. Gas projects are given the highest priority of any private company in the coordination process.

CDOT has instituted weekly PGL permit meetings, which is not done with any other utility, and meets as needed with PGL representatives to review third party OUC Existing Facility Protection submittals for conflict with existing PGL capital projects. CUB Ex. 3.1 (JA-City 3.05). When PGL requested a grace period for full compliance with CDOT's regulations in 2012, CDOT responded with a written waiver of certain requirements, proposed changes to the regulations to address PGL's stated concerns, commitments to continue to meet to clarify certain other requirements, and immediate clarifications of existing language in 2013. City/CUB Ex. 3.2. CDOT has also entered into or approved MOUs for PGL to share restoration costs with other entities opening the Public Way.

Despite CDOT's efforts to facilitate coordination and responsibility-sharing, PGL has performed poorly under the City's right of way regulation. In 2014, CDOT conducted an audit of 11 MOUs agreed to with PGL in 2013. That audit found that PGL's restoration work under 9 of the 11 MOUs was not performed to the specifications agreed to in the MOU. PGL's fines and penalties for violation of CDOT-issued permits or CDOT regulations in 2012 totaled over $300,000. The 2013 total was even greater (more than $430,000), with fines and penalties for non-compliance exceeding $50,000 in some months. Those amounts do not include costs to the City or other users of the Public Ways from PGL's non-compliant construction activities or the attendant parking, traffic, and pedestrian impacts for Chicago's ratepayers. City/CUB Ex. 3.0 at 448-450. Since 2011, PGL has been issued 3,265 ordinance violation citations by CDOT and has either pled or been found liable over 78% of the time. City/CUB Ex. 3.7. PGL has been cited for a significantly higher number of ordinance violations than the next three highest violators -- since 2011, 67% more than the next highest three violators combined.

With that kind of a record, it is difficult for CDOT to rely on the MOU to coordinate work with PGL in order to avoid waste and reduce inefficiency. City/CUB Ex. 3.0 at 618-623. (Further details of PGL's regulatory compliance difficulties are collected in Mr. Cheaks' testimony and supporting exhibits. *See* City/CUB Exs. 3.0- 3.10. CDOT regulations permit some flexibility in their application, and the City has exercised such flexibility generously to help PGL deal with some of PGL's problems. However, PGL's AMRP construction performance deficiencies go far beyond what the City can fix with special treatment. City/CUB Ex. 3.0 at 583-586. Fundamental change is needed, and going through that process again with new management will not yield timely remediation or protection of PGL's customers' service or other interests.

The Commission should act to prevent the possibly deteriorating behavior that generates these costs for PGL and others, especially since the entity asking to take over has no transition plans, has not performed due diligence on AMRP, has little to no experience with projects such as AMRP, and is unwilling to commit to substantive improvements as a condition of this reorganization. City/CUB Ex. 3.0 at 561-571. In order to protect the interests of PGL's ratepayers, Mr. Cheaks proposed, among others, the a condition to any Commission-approved reorganization that requires any Field Order Authorizations or Change Orders be communicated within 24 hours of their approval to CDOT. Mr. Cheaks testified that PGL must promptly communicate work going over schedule to CDOT to reduce the need for permit extensions or re-permitting the same location multiple times, allowing for reduced costs through coordination. City/CUB Ex. 3.0 at 485-489. Mr. Giesler admits that notification would be feasible within two business days of final approval of an FOA (JA Ex. 19. at 91-93; Tr. At 296-297, 11-22) though he asserts Change Orders is somewhat more time-consuming. JA Ex. 19.0 at 93-103. Mr. Giesler's admission that notification for FOAs is feasible supports conditioning approval of the reorganization on an FOA reporting condition. For Change Orders, the idea of a cumbersome process our of PGL's control is a red herring. At some point, PGL must receive finalized Change Orders, and CDOT should receive those Change Orders at that time. To the extent that confidentiality concerns preclude provision of this information to CDOT, City/CUB is willing to agree to the proposed condition with the following additional underlined language:

> Require that any Field Order Authorizations or Change Orders be communicated within 24 hours of their approval to CDOT<u>, subject to a confidentially agreement to protect proprietary or confidential information from disclosure</u>.

Mr. Cheaks' recommendation is consistent with and amply supported by the Interim Audit Report's recommendations: Improved coordination of plans and tasks within Peoples Gas and

the City of Chicago Department of Transportation (CDOT). Staff Ex. 8.0, Attachment A at 8, 12, 14-16, 6-8, 16-21.

Mr. Cheaks also testified that Commission approval should be conditioned on submission of a work plan to implement the Liberty Audit recommendations. City/CUB Ex. 9.0 at 137-146. Mr. Cheaks testified that the Liberty report "provides validation of my identification of many deficiencies regarding management of [AMRP]" and "it details extensive support for the conditions I described." City/CUB Ex. 9.0 at 9-13. To ensure that these past failures are not repeated or worsened post-reorganization, the Joint Applicants must provide a project work plan and report to the City that specifically addresses the recommendations of Liberty with timelines of when each recommendation would be addressed. While submission of this plan should be a condition of any approval, Mr. Cheaks recognized it may take time and asked that it be provided to the City by December 1, 2015. City/CUB Ex. 9.0 at 137-146. Without this condition, the ICC-ordered and ratepayer-funded audit may not lead to timely corrective changes under the management of a new, out-of-state entity with no specific plans for AMRP transition.

b. Utility Employee Commitments

In Commitments 2 and 3, the Joint Applicants propose to retain 1,953 Full-Time Equivalent employees ("FTEs") in Illinois for two years from closing. This number does not appear to be based on a study of actual needs to continue adequate and reliable operations in Illinois. City/CUB Ex. 1.0 (Wheat) at 6:104. The proposed post-reorganization level is 5-8% lower than the employee levels anticipated in 2015 if the reorganization does not occur. *Id.* at 8:139. The ramp-up in PGL's AMRP, which is now underway, should dictate the level of employee resources, not a commitment number that is below the estimate used to set the rates the utilities' customers are paying. The Joint Applicants' Commitment 2 should be revised to assure

that the utilities' abilities to provide service as required by the PUA will not be impaired. 220 ILCS 5/7-204(b)(1).

For the same reason, the Commitment also should be revised to maintain the current profile of employee categories. The raw numbers in the Commitment do not address this important aspect of the utilities' complement of employees. City/CUB's concern is that there is a knowledgeable cadre of skilled trades employees and construction management personnel to assure continuation and improvement of the utilities' infrastructure modernization programs. While the Joint Applicants commit to honor current union contracts, that is not an adequately specific requirement to support a Commission finding that the utilities' service abilities will not be impaired. A commitment to maintain an employee profile adequate to assure no impairment of service capabilities should be explicit in the Joint Applicants' Commitment 2.

In the course of discovery and testimony, the Joint Applicants also have confirmed that they "do not intend that their commitment in terms of FTE employee positions would permit substitution of part time positions for full time positions" and "do not intend that that their commitment in terms of FTE employee positions would permit substitution of (1) employees or positions with reduced or no employee benefits for (2) current employees or positions that have such benefits." City/CUB Ex. 1.1 (JA-City 2.10). These clarifications of the Joint Applicants' intent should be added to the Joint Applicants' Commitment 2. The Commitment revisions City/CUB propose are best enforced by requiring regular reports of these factors (profile, positions, benefit or contractor status) to the Commission, so that any changes can be detected and evaluated.

c. Utility Employee Training

To their credit, the Joint Applicants have committed to two necessary fixes to improve the future of AMRP construction by agreeing to "open a new state-of-the-art training facility for the Gas Utilities in the City of Chicago" and an extension of the veterans' worker training program located at the City Colleges of Chicago's Kennedy King College's Dawson Technical Institute. JA Ex. 6.0 at 157-160, 154-155. Both these programs will support proper modernization of Chicago's gas utility infrastructure, by assuring the availability of properly trained skilled workers for the decades-long AMRP undertaking. (As discussed under section 7-204(f), City/CUB note that the Joint Applicants oppose modifying their employee commitment (Commitment 2) to assure the proper mix of skilled employees.) City/CUB Ex. 7.0 at 166-178. However, these commitments alone are insufficient to protect PGL's ratepayers' AMRP interests, since they fail to prove, by a preponderance of the evidence, that management and operation of AMRP will not worsen PGL's service abilities. 220 ILCS 5/7-204(B)(1) and (f).

d. Illinois Board Member

The Joint Applicants have given no reason for refusing to require that the Illinois Board member be a customer of one of the Illinois utilities. The Joint Applicants state that their guidance for Commitment 36, requiring an Illinois resident on the reorganized entity's board of directors, was the Commission's decision in the *Nicor Merger*.

> [T]he only other reorganization docket the Joint Applicants could find where the Commission included a board member residency condition is the AGL-Nicor Gas reorganization, Docket No. 11-0046 . . . . Here, as in the AGL-Nicor Gas reorganization, the Joint Applicants have committed to maintaining at least one WEC Energy Group board member from Illinois.

JA Ex. 6.0 (Leverett) at 30:760.

The Joint Applicants have missed the point of that Commission-imposed condition. The Commission explained its reasons for imposing the condition -- ownership of an Illinois utility by a foreign corporation, the clear legislative policy of protecting utility and customer interests, and ensuring the presence of a board member with "first-hand knowledge of the issues and concerns unique to [the foreign company's] Illinois utilities and their customers." *Nicor Merger* at 15.

> Additionally, in response to the concerns raised by parties related to the fact that AGL is a non-Illinois incorporated entity, the Commission finds it appropriate to impose an additional requirement to be fulfilled by the JA in this matter. We hereby direct that for as long as AGL owns, controls, or manages NG or its successor entity, it shall have at least one non-employee individual resident of Illinois on AGL's Board of Directors. AGL has sole discretion in selecting qualified candidates and determining which individual is the best qualified for such nomination. We find that this requirement will further satisfy the spirit and goals of the provisions of the Act at issue in this case by ensuring that AGL's Board of Directors include a member having first-hand knowledge of the issues and concerns unique to its Illinois utilities and their customers.

Id.

Only a customer of one of the affected Illinois utilities can provide that <u>first-hand</u> knowledge of the concerns of the utilities' customers. Since the utilities serve a major portion of Illinois residents and its chief business center, finding a qualified PGL or NS customer should not be difficult. The Joint Applicants' Commitment 36 should be modified to add a requirement that the Illinois board member be a customer of one of the Illinois utilities involved in the proposed reorganization.

H. The Joint Applicants' Claimed Benefits Are Vague, Provide No Value to Customers, and Do Not Offset the Reorganization's Adverse Impacts

There is a stark contrast between clearly identified benefits for the proposed reorganized entity and the vague alleged benefits for the Illinois utilities and their customers. Few of the

purported benefits of the proposed reorganization are quantified. Most claimed benefits are more accurately described as "opportunities" -- for which the Joint Applicants have presented no plans that will realize potential benefits for ratepayers. The Joint Applicants' claimed consumer benefits are based almost entirely on possibilities and potential, at some unspecified future time. *See, e.g.,* JA Ex. 1.0 (Leverett) at 15:316 ("may generate benefits"); JA Ex. 3.0 (Reed) at 30:627 ("unlocks the opportunity for increased efficiencies"), 31:646 ("opportunities to optimize"), 32:653 ("supportive of environmental stewardship"). The Joint Applicants have provided no concrete, quantified, or verifiable evidence that the Commission can rely upon.

Even balanced against unquantified, intangible adverse impacts of the proposed reorganization, the claimed benefits come second in genuineness. In contrast to the smoke-like qualities of the Joint Applicants' benefit claims, qualitative impacts like the loss of local ownership, relocation of the utilities' headquarters, and displacement of management policies attuned to Illinois regulatory policy have consequential effects on Illinois regulators, utilities, and ratepayers that are relevant to the determination in this case. The Joint Applicants acknowledge the negative effect of an "acquirer whose focus may be broader than Illinois and the region." JA Ex. 3.0 at 39:797. The Commission has found the same factor relevant in another reorganization. *Nicor Merger* at 15. In addition, the physical relocation of the utility headquarters presents challenges for the Commission responsible for regulating Illinois utilities (regardless of ownership, "comprehensively and effectively"). 220 ILCS 5/1-102. The Joint Applicants do not dispute that a change in ownership is likely to lead to changed management policies. Tr. 137 (Schott). Such changes may be problematic, where, for example, dividend policies of the parent reduce the funding available for critical utility infrastructure investment.

City/CUB witness William Cheaks examined other effects of the reorganization that (though not easily quantified) have significant impacts on ratepayers in the City and Illinois. He explains the potential consequences for City ratepayers of reorganization effects like changes in personnel knowledgeable about City-utility AMRP construction activities, removal of decision-making for local operations, the effect of upper management changes on budgeting decisions, and loss of personal, local knowledge about the concerns of City customers. City/CUB Ex. 7.0 at 4-5, Chart.

The Joint Applicants tout the supposed financial benefits of the reorganization. Yet, the testimony of the Joint Applicants does not clearly identify either mechanisms by which the claimed benefits could be realized or any plans to deploy the resources of the reorganized entity to the benefit of Illinois utilities or customers. In fact, the Joint Applicants were asked in discovery to

> describe -- using detailed (illustrative) example -- specific financial mechanisms by which (a) WEC's "greater financial liquidity and improved access to capital markets" [citation omitted] will provide financial benefits to PGL and its ratepayers; and (b) the reorganization will enhance the gas Companies' ability to raise necessary capital on reasonable terms . . ."

City Group Cross Ex. 1, JA-City 7.02 and 10.54. The Joint Applicants responded without identifying a single capable mechanism by which the claimed benefits would flow to the supposed beneficiaries. *Id.*

Contrast the Joint Applicants' promises ("WEC has committed to maintain the current main replacement program and WEC Energy Group may be able to deploy its strong cash flows to fund those types of projects." JA Ex. 3.0 (Reed) at 30: 606) with the reality ("there are no specific plans at the present time with respect to the use of WEC Energy Group's cash flows for

the funding of Peoples Gas' AMRP"). City Group Cross Ex. 1, JA-City DRR 2.22). This disparity is typical of the Joint Applicants' claimed reorganization benefits. Under the proposed reorganization, "Peoples Gas will maintain its own credit facilities," "there is no plan for Peoples Gas to issue securities in the equity markets," and "[t]he Joint Applicants are not requesting any change in the way the Commission determines Peoples Gas' cost of equity." *Id.*, JA -City DRR 2.21. The Joint Applicants have provided no concrete plans or assurances that any benefits resulting from the merger will indeed flow to the utilities or their customers.

I. Investigation into Anonymous Letters Alleging Misconduct and Improprieties

Concurrently with its consideration of this proposed reorganization, the Commission has initiated ICC Docket No. 15-0186, *ICC on its own motion v. Peoples Gas Light and Coke Company, Investigation into anonymous letter alleging misconduct and improprieties related to the PGL AMRP* ("Investigation"). The Investigation was initiated in response to two recently received "whistleblower" letters, filed as *ex parte* communications in this docket, which allege serious misconduct on the part of PGL, Integrys, and WEC regarding the implementation of AMRP, as well as in the Commission-ordered investigation of AMRP. The Staff Report supporting the Initiating Order of the Investigation Staff noted that the first "whistleblower letter" (the only one they had received at that time):

> …alleges numerous incidents and improper practices being conducted by individuals associated with WEC, Integrys and Peoples. All three entities are currently before the Commission in connection with Docket No. 14-0496, in which WEC is seeking Commission authorization to acquire both Integrys and Peoples. The allegations in the anonymous letter relate to the acquisition/merger process, the audit process as well as Peoples' management of its AMRP.

ICC Docket No. 15-0186, Staff Report of March 5, 2015 at 1.[10] The Report goes on to acknowledge that the parties to the reorganization have an obvious interest in these issues by recommending that they be permitted to intervene in the Investigation.

On March 24, the City, CUB and the AG filed a Motion for Extension of the Schedule and Motion to Hold Open the Record for Additional Evidence ("Motion") in this case, pursuant to Section 7-204(d) of the PUA. That Section allows the deadline in a proposed reorganization case to be extended in certain circumstances. 220 ILCS 5/7-204(d). Such circumstances include an extension of up to three months "to consider reasonably unforeseeable changes in circumstances subsequent to the Applicant's initial filing." *Id.* City/CUB maintain that the information in the "whistleblower" letters, as well as the Commission's response to those letters (issuing Commissioners' Data Requests on March 11, 2015, in this proceeding, seeking more information regarding transition plans to assure no impairment of service (especially of AMRP) in the event of a reorganization, and initiation the Investigation) constitute reasonably unforeseeable changes of circumstances warranting the relief provided by Section 7-204(d). All of this new information (and anticipated new information, brought to light as the Investigation proceeds) is directly relevant to the Commission's consideration of the Joint Applicants' proposed reorganization. The dysfunction in PGL's AMRP is no longer disputed. Tr. 329 (Hesselbach). There are reports of new, corrective efforts at PGL/Integrys, but they are at a nascent stage. The details of those efforts and any AMRP implementation improvements are not yet public. JA Ex. 13.0 CONF at 8:166. While the Joint Applicants assert that they are "ready,

[10] A Corrected Initiating Order was issued after the Commission received a second whistleblower letter. The corrections made clear that the same concerns applied to that letter and that the Investigation was expanded to include the allegations in that letter and any future allegations of a similar nature. ICC Docket No. 15-0186, Corrected Initiating Order of March 11, 2015 at 1.

willing, and able" to implement AMRP more efficiently (*id*. at 3:53), the Commission lacked detail on the Joint Applicants' transition plans, if they exist, and sought more information through its Data Requests. Information on (a) whether and how continuation of any planned improvements to AMRP implementation will be accomplished, (b) whether the transition will prolong program dysfunction and continued deterioration in PGL's AMRP, and (c) whether and how any improvements being made in AMRP implementation will be seamlessly continued is directly relevant to the statutory criteria for Commission approval in this proceeding. However, the evidence in the current record from the Joint Applicants on these issues is sparse.

City/CUB maintain that the Commission cannot make a fully-informed decision on whether to grant the proposed reorganization (and, if so, what conditions are appropriate) without some consideration of the allegations that will be considered in the Investigation. First, information gathered in the investigation may be relevant to the Commission's decision as to whether to transfer control of the Utilities to entities that may be found to have engaged in unscrupulous or even unlawful behavior.[11] Once consummated, there is no easy way to undo the transaction, and the Commission may find itself in the position of defending its approval of a transfer of Peoples and North Shore to a company it later determines engaged in improper actions. Second, the Investigation may reveal a need for additional conditions to any merger approval that are necessary to protect the public interest. The Commission must at least consider the allegations in the "whistleblower" letters, and information learned in the Investigation, in order to fulfill its responsibilities under Section 7-204, which require, at a minimum, that

[11] GCI are aware that that the allegations in the two whistleblower letters are just that - allegations. Those allegations have not been proven. However, the Commission believed that the allegations were sufficiently serious that it decided to open the Investigation to determine whether the allegations have merit. Having initiated the Investigation, the Commission should be wary of moving forward in this case without considering the possibility that the allegations may have merit.

appropriate conditions are attached to any merger approval. City/CUB implore the Commission to grant the Motion, and to defer making any decision in this case until it has had the opportunity to consider evidence that is expected to come to light in the Investigation.

IV. CONCLUSION

The record evidence precludes Commission approval of the proposed reorganization. The Joint Applicants apparently recognized the deficiencies of the proposal and have attempted to close the gap between the proposal's impacts and the protective requirements of the statute, by proposing supplemental Commitments. However, even with the supplemental Commitments the Joint Applicants offer, the statutory findings, at the required level of certainty, are not supported by the Joint Applicants' evidence or the record as a whole. The Commission must reject the proposed reorganization, because the Joint Applicants have not shown that the proposal meets the statutory requirements. If the reorganization is approved despite its shortcomings, the Commission must impose strengthened Commitments and additional protective conditions, as proposed by City/CUB.

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Respectfully submitted,

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